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Publications

ANNUAL FINANCIAL REPORT

of the Government of Canada

Fiscal Year 1998-99

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Annual Financial Report

of the Government of Canada

Fiscal Year 1998-99

For the fiscal year 1998-99, there was a budgetary surplus of $2.9 billion. Together with the $3.5-billion surplus recorded in 1997-98, this marks only the second surplus since 1969-70 and the first back-to-back surpluses since 1951-52. With these surpluses, the absolute stock of net public debt has declined by $6.4 billion in two years and net public debt as a percentage of the economy is on a permanent downward track. Market debt – the debt issued on credit markets – fell even faster than net public debt. Over the last two fiscal years, $16.4 billion of market debt has been retired.

This turnaround in federal government finances is a historic milestone and represents an achievement that all Canadians can truly be proud of, for without their efforts, it would not have been possible. This turnaround also underlines the soundness of the government's fiscal strategy – basing budget plans on prudent planning assumptions backed by a Contingency Reserve and adopting policies which have engendered economic growth and job creation. With the era of deficit financing now over, Canada is entering the new millennium with renewed financial credibility.

Department of Finance Canada   Ministère des Finances Canada

Actions to address the fiscal problem facing Canada were both balanced and measured. Even as the deficit was being eliminated, targeted investments were undertaken to enhance job creation and growth and address priorities in health care, knowledge and innovation. In the 1997 budget, the government announced the establishment of the Canada Foundation for Innovation, with an initial endowment of $800 million. In the 1998 budget, the Canadian Opportunities Strategy was launched. Central to that strategy was the establishment of the Canada Millennium Scholarship Foundation, with an endowment of $2.5 billion. Effective 1997-98, the cash floor under the Canada Health and Social Transfer (CHST) was increased from $11 billion to $12.5 billion. In the 1999 budget, a one-time supplement of $3.5 billion to the CHST was made from funds available in 1998-99. In addition, the 1998 and 1999 budgets began the process of providing affordable broad-based tax cuts to all Canadians. In the 1998 budget, personal income tax measures amounting to $1.1 billion were announced for 1998-99. The 1998 and 1999 budget tax measures will mean further savings of $16.5 billion for Canadians over the next three years. In addition, employment insurance premium rates for both 1998 and 1999 were cut, delivering savings of some $800 million in both 1998-99 and 1999-2000. These initiatives were financed within the available resources and not with borrowed money.

This is the sixth edition of the *Annual Financial Report*. Publication of the report responds to recommendations by the Auditor General and the House of Commons Standing Committee on Public Accounts. The government shares their view that providing Canadians with accurate, relevant, understandable and timely information on its financial activity enhances government accountability and enables Canadians to play a more active and effective role in guiding government decision-making. To make the report more useful and easier to understand, a survey form is attached to solicit users' views for further improvements.

The financial data in this report are based on the audited results, which will appear in more detail in the 1999 *Public Accounts of Canada*, scheduled for tabling in the House of Commons this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 1998-March 31, 1999), and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* have been updated to incorporate the results for 1998-99 and historical revisions to the *National Economic and Financial Accounts* published by Statistics Canada. These tables are an integral part of this report.

The Honourable Paul Martin, P.C., M.P.
Minister of Finance

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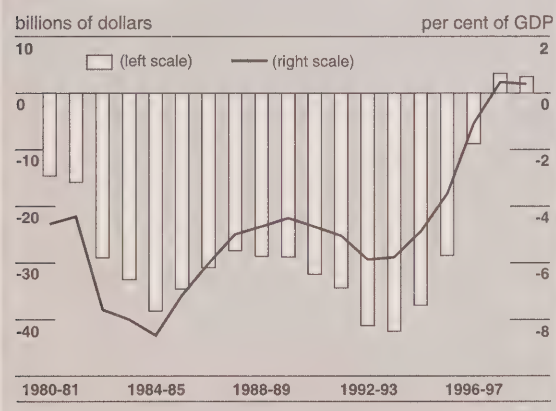
- Budgetary surplus of $2.9 billion in 1998-99, following a surplus of $3.5 billion in 1997-98: first back-to-back surpluses since 1951-52.
- Net public debt, at $576.8 billion, down $6.4 billion since 1996-97; net public debt-to-GDP ratio down to 64.4 per cent from a peak of 71.2 per cent in 1995-96.
- Market debt – the debt issued on credit markets – fell even faster than net public debt. Over the last two fiscal years, $16.4 billion of market debt has been retired.
- By accounting practices used in most other countries, a financial surplus for the third consecutive year was reported – the only G-7 country to do so.

The budgetary balance

In 1993-94, the federal deficit stood at $42 billion. The actions taken in the 1994, 1995 and 1996 budgets, coupled with sustained economic growth, resulted in the elimination of that deficit in just four years. In 1997-98, a budgetary surplus of $3.5 billion was recorded, the first surplus in 28 years. This has now been followed by a surplus of $2.9 billion in 1998-99.

This turnaround in the budgetary balance reflected the combined effects of lower program spending, primarily reflecting the expenditure reduction measures introduced since 1993, and higher revenues, primarily reflecting the growth in the economy. The contributions are best viewed in terms of their relationship to gross domestic product (GDP). Over the period 1993-94 to 1998-99, there was an improvement of 6.1 percentage points of GDP in the budgetary balance – from a deficit of 5.8 per cent of GDP to a surplus of 0.3 per cent. Over two-thirds of this improvement was attributable to the decline in program spending – from 16.6 per cent of GDP in 1993-94 to 12.4 per cent in 1998-99. Budgetary revenues increased by 1.4 percentage points of GDP – representing about 23 per cent of the overall improvement in the budgetary balance. Public debt charges declined by 0.6 percentage points, accounting for about 10 per cent of the improvement in the budgetary balance.

The budgetary balance



Sources: Public Accounts of Canada and Statistics Canada.

Net public debt

The 1998-99 surplus brought the federal government's net public debt – the accumulation of annual deficits and surpluses – down to $576.8 billion. As a share of GDP, the net public debt dropped to 64.4 per cent, down 6.8 percentage points from the peak of 71.2 per cent in 1995-96. This ratio is generally recognized as the most appropriate measure of the debt burden as it measures debt relative to the ability of the government and the country's taxpayers to finance it. This is the third

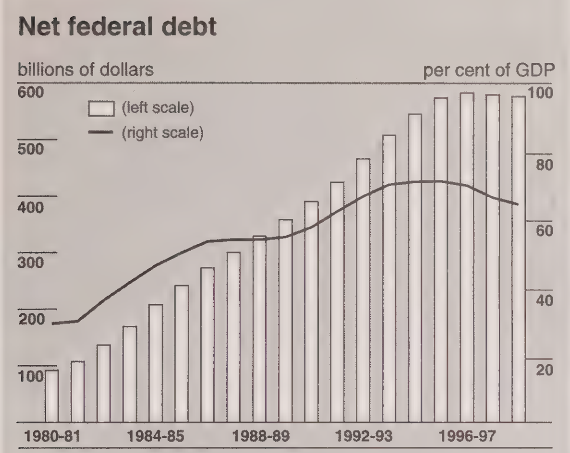
Table 1
Financial highlights

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
			(billions of dollars)			
Budgetary transactions						
Revenues	116.0	123.3	130.3	140.9	153.2	155.7
Program spending	-120.0	-118.7	-112.0	-104.8	-108.8	-111.4
Operating balance	-4.0	4.6	18.3	36.1	44.4	44.3
Public debt charges	-38.0	-42.0	-46.9	-45.0	-40.9	-41.4
Budgetary balance	-42.0	-37.5	-28.6	-8.9	3.5	2.9
Non-budgetary transactions	12.2	11.6	11.4	10.2	9.3	8.6
Financial requirements/surplus (excludes foreign exchange transactions)	-29.9	-25.8	-17.2	1.3	12.7	11.5
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2	-5.7
Net financial balance	-32.0	-27.3	-21.9	-6.5	10.6	5.8
Net change in borrowings	31.2	27.0	28.5	7.3	-9.6	-6.9
Net change in cash balances	-0.7	-0.2	6.7	0.8	1.0	-1.1
Financial position						
Total liabilities	-546.4	-584.8	-624.7	-640.7	-638.5	-640.3
Total assets	38.2	39.1	50.4	57.5	58.8	63.5
Accumulated deficit (net public debt)	-508.2	-545.7	-574.3	-583.2	-579.7	-576.8
Financial results (% of GDP)						
Budgetary revenues	16.0	16.1	16.1	16.9	17.5	17.4
Program spending	16.6	15.5	13.9	12.6	12.4	12.4
Public debt charges	5.2	5.5	5.8	5.4	4.7	4.6
Budgetary balance	-5.8	-4.9	-3.5	-1.1	0.4	0.3
Net public debt	70.1	71.1	71.2	69.9	66.3	64.4

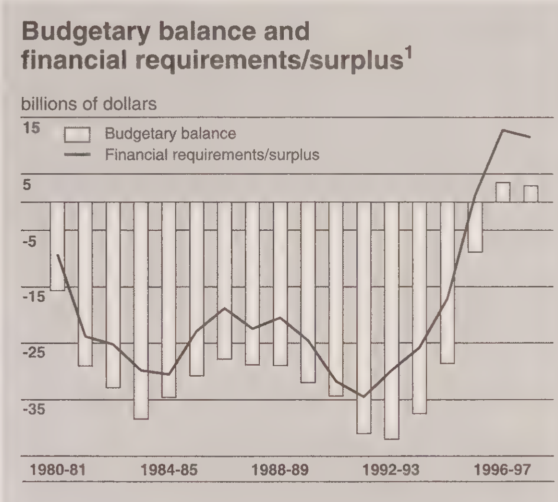
consecutive year in which the debt-to-GDP ratio has declined. The ratio is now back to where it was in the early 1990s, but still well above what it was in the 1970s. The net public debt at the end of 1998-99 was $18,923 for each Canadian, down from $19,184 a year earlier.

Net public debt consists of interest-bearing debt and other liabilities, net of financial assets. Interest-bearing debt, in turn, consists of unmatured, or market, debt and the government's obligations to internally held accounts – primarily the liabilities for the federal government employees' pension plans.

- In 1998-99, interest-bearing debt was $595.0 billion, up $0.2 billion from 1997-98.
- However, of this, market debt declined by $6.9 billion to $460.5 billion. This reflected a lower stock of Treasury bills (down $15.4 billion) and Canada Savings Bonds (down $2.1 billion), offset in part by higher marketable bonds (up $10.0 billion) and bonds for the Canada Pension Plan (up $0.6 billion).
- This decline in market debt was offset by an increase of $7.1 billion in liabilities to public sector pensions and other accounts.



Sources: Public Accounts of Canada and Statistics Canada.



[1]Excluding foreign exchange transactions.
Sources: Public Accounts of Canada and Statistics Canada.

The financial balance

Financial requirements/surplus measures the difference between cash coming into the government and cash going out. Most industrialized countries currently use a measure comparable to the financial requirements/surplus as their main budget measure.

- There was a financial surplus (excluding foreign exchange transactions) of $11.5 billion in 1998-99. This is the third consecutive year in which a financial surplus has been recorded – the only G-7 country to do so.

During the course of the fiscal year, there was a net requirement of $5.7 billion relating to foreign exchange transactions, up from a net requirement of $2.2 billion in 1997-98. Including these amounts, the financial surplus in total was $5.8 billion. This compares to a financial surplus of $10.6 billion in 1997-98.

BUDGETARY REVENUES

Table 2 on page 11 shows budgetary revenues on both a budget, or "net", basis as well as on a "gross" basis. The net figures reflect the way in which revenues and expenditures are presented to Parliament and in the government's annual budget. As such, there are a number of tax expenditures which are netted against revenues and a number of revenue items that are netted against spending.

Netted against revenues are:

- the Canada Child Tax Benefit;
- the quarterly goods and services tax (GST) credit; and
- repayments of Old Age Security benefits.

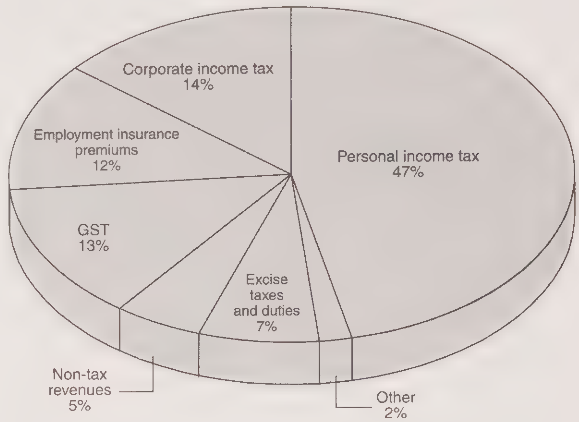
Netted against spending are:

- revenues of consolidated Crown corporations; and
- revenues levied by departments for specific services, such as the costs of policing services in provinces.

On a gross basis, the tax expenditures netted against revenues are included as part of spending, while the items netted against spending are included as part of revenues, thereby increasing both revenues and spending with no impact on the balance.

On a net basis, revenues amounted to $155.7 billion in 1998-99, an increase of $2.5 billion, or 1.6 per cent, from the 1997-98 level. The revenue ratio – net budgetary revenues as a percentage of GDP – represents an approximate measure of the overall "tax burden" in that it compares the total of all revenues collected to the size of the economy. However, as some important components of income subject to taxation are excluded from the Statistics Canada measure of GDP, such as capital gains and income from trusteed pension plans, this ratio overstates the tax burden. In addition, the sharp rise in capital gains and the growth in income from trusteed pension plans due to the aging of the population distort year-to-year changes in the ratio. Therefore, caution should be exercised in interpreting this ratio. The revenue ratio stood at 17.4 per cent in 1998-99, down slightly from 17.5 per cent in 1997-98. This decline reflects lower corporate income tax revenues and the impact of the tax relief measures announced in the 1998 budget, which restrained the growth in personal income tax revenues.

Composition of net revenues for 1998-99



Source: Public Accounts of Canada.

Net personal income tax revenues, the largest component of budgetary revenues, were up $1.7 billion, or 2.4 per cent, in 1998-99. This is in sharp contrast to the increase of 11.9 per cent reported in 1997-98. This slowdown in the rate of growth was attributable to the tax relief measures announced in previous budgets and prior-year adjustments.

- In the 1998 budget, the amount of income that low-income Canadians can receive on a tax-free basis was increased by $500. In addition, the general federal surtax was eliminated for Canadians earning up to about $50,000 and reduced for those earning between $50,000 and $65,000. It is estimated that these measures reduced tax revenues by $0.9 billion in 1998-99. There were a number of other tax expenditure measures (credit for interest on student loans, part-time education tax credit, caregiver credit, among others) which served to reduce taxes otherwise

payable. In consultation with provincial governments, the Child Tax Benefit was restructured to create an enriched Canada Child Tax Benefit (CCTB). These changes came into effect July 1, 1998 and reduced personal income tax revenues by about $0.4 billion in 1998-99.

- Prior-year adjustments also affected the flow of personal income tax revenues in both 1997-98 and 1998-99. For example, refunds were up $1 billion in 1998-99, reflecting overpayment of taxes pertaining to the 1997 taxation year. In contrast, refunds were lower in 1997-98 than in 1996-97. Gross remittances received include not only federal personal income tax liabilities but also provincial income tax liabilities (as set out under the tax collection agreements with participating provinces) and employee and employer premium contributions for employment insurance and the Canada Pension Plan. On a monthly basis, deductions for these liabilities are based on estimates, with adjustments made once either preliminary or final data become available from Revenue Canada. In 1997-98, there were large transfers to personal income tax revenues, pertaining to overestimations of these deductions during the course of the fiscal year. The reverse occurred in 1998-99.
- According to Statistics Canada, personal income – a proxy for the applicable tax base for personal income tax revenues – advanced by 4 per cent in 1998, compared to an increase of 3.7 per cent in 1997. Although personal income excludes some important income components subject to taxation, such as capital gains and income from trusteed pension plans, the underlying growth in personal income tax revenues is broadly in line with the growth in personal income.

Corporate income tax revenues declined $0.9 billion, or 4.1 per cent, in 1998-99, as profits fell by 6 per cent in 1998. Other income tax revenues, which closely mirror the performance of corporate income tax revenues, were down $73 million, or 2.4 per cent.

Employment insurance premium revenues increased $0.6 billion, or 3 per cent, in 1998-99. However, this increase was entirely attributable to prior-year adjustments.

- As noted above, in 1997-98, there was a transfer from employment insurance premium revenues to personal income tax revenues, reflecting underpayments with respect to the 1996 taxation year.
- However, in 1998-99, there were net transfers from personal income tax revenues due to overpayments with respect to previous taxation years. The net impact of these adjustments was about $0.8 billion, implying a decline in underlying revenues in 1998-99.
- This decline was attributable to the reduction in premium rates. The employee premium rate (per $100 of insurable earnings) was reduced from $2.90 for 1997 to $2.70 for 1998 and to $2.55 for 1999 (with a corresponding decline in the employer rate). The net impact of these rate reductions was to lower revenues by about $1.5 billion.
- Dampening the effect of these rate reductions was an increase in the number of people employed.

The revenue ratio

Sources: Department of Finance and Statistics Canada.

Net excise taxes and duties increased $0.5 billion, or 1.7 per cent, down from a gain of 6.1 per cent recorded in 1997-98. There were significant variations among the various components.

- Net GST revenues were up 6.3 per cent. Excluding the quarterly GST credit, gross revenues were up 5.3 per cent, roughly in line with the growth in the applicable tax bases.
- Customs import duties declined 14.7 per cent, reflecting reductions in tariffs, as specified under international agreements.
- Other excise taxes and duties include customs import duties, excise taxes on motive fuels, excise taxes and duties primarily on tobacco and tobacco products, and the air transportation tax. They were down 3.2 per cent, due initially to the reduction in the air transportation tax effective January 1, 1998 and to its subsequent elimination effective November 1, 1998.

Non-tax revenues include return on investments and other non-tax revenues, such as net proceeds from the sale of assets, user charges, etc. Net non-tax revenues increased $0.7 billion, or 9.7 per cent, in 1998-99, primarily reflecting higher Bank of Canada profits and gains from the foreign exchange accounts.

Gross budgetary revenues in 1998-99 were $11.9 billion higher than net budgetary revenues, of which $5.7 billion was for the CCTB, $2.9 billion for the quarterly GST credit, $1.5 billion for revenues of consolidated Crown corporations and $2.3 billion for revenues levied by departments, which are credited back to the programs giving rise to these revenues. Old Age Security benefit repayments increased net revenues by $0.5 billion. The increase in the CCTB payments was attributable to the increase in benefits announced in the 1997 budget.

Table 2
Budgetary revenues

	1997-98	1998-99	Net change	
		($ millions)		(%)
Net income tax collections				
Personal income tax	70,787	72,488	1,701	2.4
Corporate income tax	22,496	21,575	-921	-4.1
Other	2,974	2,901	-73	-2.4
Total	96,257	96,964	707	0.7
Employment insurance premium revenues	18,802	19,363	561	3.0
Net excise taxes and duties				
Goods and services tax (GST)	19,461	20,684	1,223	6.3
Customs import duties	2,766	2,359	-407	-14.7
Other excise taxes/duties				
Energy taxes	4,638	4,716	78	1.7
Other	3,995	3,640	-355	-8.9
Total	8,633	8,356	-277	-3.2
Total	30,860	31,400	540	1.7
Net tax revenues	145,919	147,726	1,807	1.2
Net non-tax revenues				
Return on investments	4,427	4,991	564	12.7
Other non-tax revenues	2,816	2,954	138	4.9
Total	7,243	7,945	702	9.7
Net budgetary revenues	**153,162**	**155,671**	**2,509**	**1.6**
Adjustments				
Canada Child Tax Benefit	5,352	5,715	363	6.8
Old Age Security benefit repayment	-467	-496	-29	6.2
Quarterly GST credit	2,892	2,850	-42	-1.5
Revenues netted against expenditures	2,196	2,305	109	5.0
Revenues of consolidated Crown corporations	1,227	1,498	271	22.1
Net adjustment	11,200	11,872	672	6.0
Gross budgetary revenues	**164,362**	**167,543**	**3,181**	**1.9**

Budgetary Expenditures

Table 3 on page 16 presents budgetary expenditures on both a gross and net basis. The differences are identical to those between gross and net budgetary revenues.

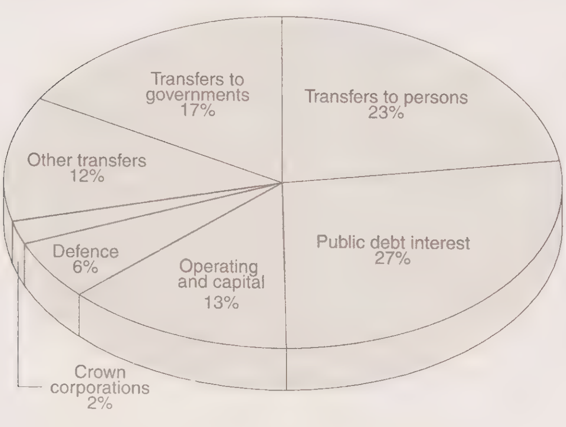
Net budgetary expenditures amounted to $152.8 billion in 1998-99, up $3.1 billion, or 2.1 per cent, from 1997-98. The expenditure ratio – net budgetary expenditures as a percentage of net budgetary revenues – stood at 98.1 per cent, up slightly from 1997-98. This implies that, in 1998-99, revenues exceeded total expenditures by 1.9 per cent. In 1993-94, the expenditure ratio stood at 136.2 per cent, which meant that an amount equivalent to 36.2 per cent of revenues had to be financed by borrowings.

Public debt charges increased by $0.5 billion, or 1.1 per cent, in 1998-99. Public debt charges are affected by interest rate developments as well as by the stock and composition of interest-bearing debt.

- The average effective interest rate on the government's interest-bearing debt (unmatured debt and pension liabilities) was 7.4 per cent in 1998-99, compared to 7.3 per cent in 1997-98. The average effective interest rate on unmatured debt was 6.7 per cent, while that on pension and other accounts was 9.8 per cent. Since 1990-91, the average effective interest rate on interest-bearing debt has declined by 3.5 percentage points, with virtually all of this attributable to lower average effective interest rates on unmatured debt – down 4.5 percentage points.
- The stock of interest-bearing debt increased slightly in 1998-99, from $594.8 billion to $595.0 billion: the stock of unmatured debt declined by $6.9 billion to $460.4 billion, while the liabilities to pension and other accounts increased by $7.1 billion to $134.6 billion. Since 1990-91, the share of unmatured debt has declined by about 2 percentage points with a corresponding increase in the liabilities for pension and other accounts. Within unmatured debt, the share of marketable bonds has increased by over 25 percentage points, while that for Treasury bills and Canada Savings Bonds has declined.

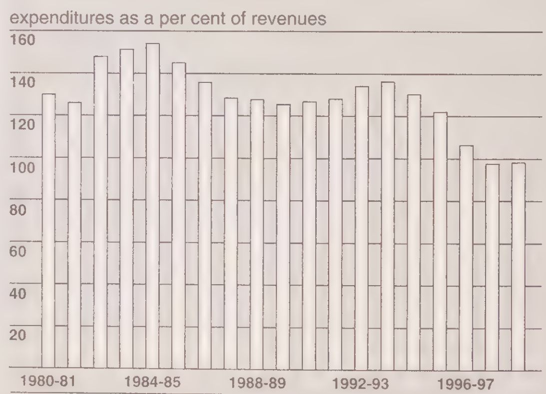
The interest ratio – public debt charges as a percentage of net budgetary revenues – declined only marginally from 26.7 per cent in 1997-98 to 26.6 per cent in 1998-99. This ratio means that, in 1998-99, the government spent about 27 cents of every revenue dollar for interest on the public debt. This is down from the peak of 36 cents in 1995-96. This is money that must be paid to

Composition of net expenditures for 1998-99

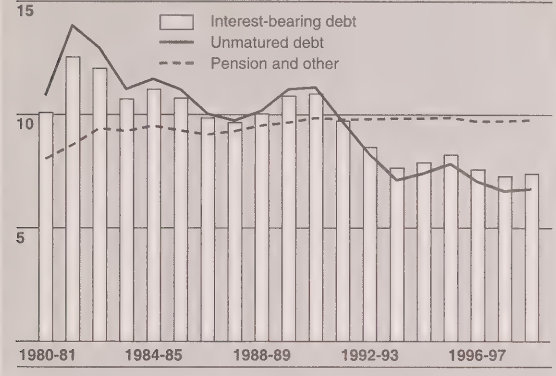


Source: Public Accounts of Canada.

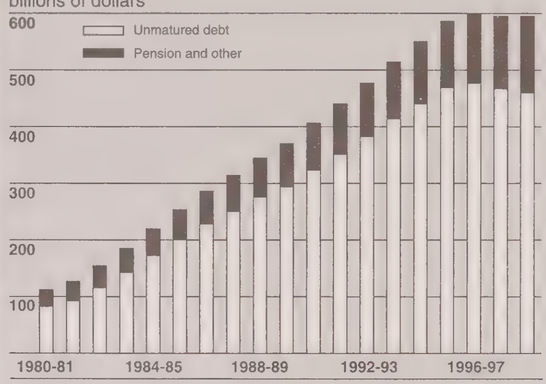
The expenditure ratio



Source: Public Accounts of Canada and Statistics Canada.



Source: Public Accounts of Canada.



Source: Public Accounts of Canada.

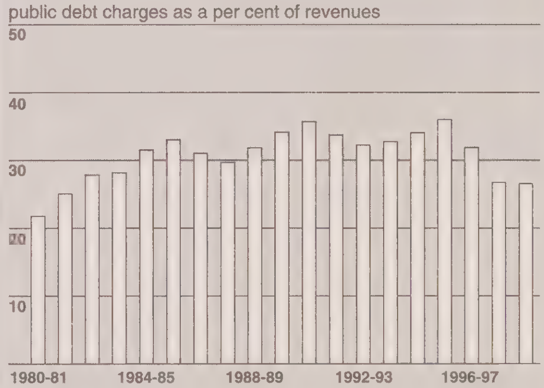
meet the government's obligations on its debt. The lower the ratio, the more flexibility the government has to address the key priorities of Canadians.

Net program spending – net budgetary expenditures less public debt charges – increased by $2.6 billion, or 2.4 per cent, in 1998-99. As was the case in 1997-98, a number of initiatives undertaken during the course of 1998-99 raised the overall level of program spending. These included the one-time cash supplement of $3.5 billion to the Canada Health and Social Transfer and incremental funding of $0.4 billion to the Canada Foundation for Innovation, the Canadian Institute for Health Information and the Canadian Health Services Research Foundation. Funding was also provided for the Canadian Fisheries Adjustment and Restructuring Program and the Agricultural Income Disaster Assistance Program (total of $1 billion). In addition, Equalization entitlements increased significantly ($1.6 billion), reflecting prior-year data revisions.

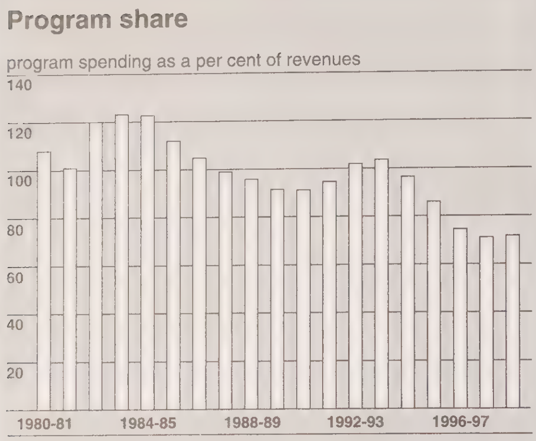
The program share – net program spending as a percentage of net revenues – amounted to 71.6 per cent, up slightly from 1997-98 but still well below previous levels.

Within program spending, net major transfer payments to persons consist of elderly benefits and employment insurance benefits. This component increased by $0.6 billion, or 1.8 per cent, in 1998-99.

- Elderly benefits consist of Old Age Security payments, Guaranteed Income Supplement payments and spouse's allowance payments. Total benefits were up $0.6 billion in 1998-99, reflecting both higher average benefits and an increase in the number of recipients.



Source: Department of Finance.



Source: Department of Finance.

- Employment insurance benefits were virtually unchanged from 1997-98. Regular benefit payments were lower, reflecting the decline in the number of unemployed. However, this was offset by increased transfers to the provinces under the Labour Market Development Agreements.

Major transfer payments to other levels of government include the Canada Health and Social Transfer (CHST), fiscal arrangements (Equalization, transfers to the territories as well as a number of small transfer programs) and Alternative Payments for Standing Programs. Net cash transfers increased by $5.0 billion in 1998-99, or 24.5 per cent. Of this increase, $3.5 billion was attributable to the CHST cash supplement while the remainder was attributable to higher Equalization payments.

- On April 1, 1996, the CHST – a new block-funded transfer – replaced Established Programs Financing and the Canada Assistance Plan. Total CHST entitlements are paid in the form of tax point transfers and cash transfers. In the 1998 budget, CHST entitlements were forecast to be $26 billion for 1998-99. The budget also set a floor on the cash portion of the transfer at $12.5 billion for the years 1997-98 to 2002-03. Without this floor, the cash entitlement would have fallen below $12.5 billion in both 1997-98 and 1998-99.
- In the 1999 budget, the government announced a special payment of $3.5 billion to be paid to a third-party trust to be drawn by the provinces and territories over a period not to exceed three years, in a pattern which best meets the needs of their health care systems. This supplement was charged to the 1998-99 fiscal year, in accordance with objective accounting standards.
- Equalization is the largest of the transfers under fiscal arrangements. Under the Equalization program, the federal government transfers funds to the less prosperous provinces so that they can provide reasonably comparable levels of public services at reasonably comparable levels of taxation. Tax data for 1997 indicated much stronger revenue gains in the non-Equalization-receiving provinces than in the Equalization-receiving provinces, thereby resulting in higher Equalization entitlements.
- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allowed provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provided provinces with tax points, the value of which are netted against total entitlements, and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Net direct program spending – total program spending less major transfers to persons and other levels of government – consists of subsidies and other transfer payments, expenditures related to Crown corporations, defence spending, and operating and capital expenditures of non-defence departments and agencies.

- Spending in this component amounted to $51.2 billion in 1998-99, down $3.0 billion, or 5.5 per cent, from 1997-98. This decline was attributable to the recording of a number of one-time liabilities in 1997-98 amounting to $5.5 billion: liabilities for the Canada Millennium Scholarship Foundation ($2.5 billion), compensation for hepatitis C victims ($0.8 billion), the Aboriginal healing

strategy ($350 million) and the change in accounting policy relating to assistance to international financial institutions ($1.8 billion).

- Excluding the impact of these liabilities, direct program spending increased by $2.5 billion, or 5.1 per cent. This increase was entirely attributable to the initiatives announced in the 1998 and 1999 budgets ($1.9 billion) and the economic adjustment programs for farmers and fishers ($1 billion).

Within net direct program spending:

- Subsidies and other transfer payments declined by $3.7 billion, with the decline attributable to the special factors noted above ($5.5 billion). Partially offsetting the impact of these liabilities were:
  - booking of the 1998-99 liabilities associated with the Agricultural Income Disaster Assistance Program;
  - payments under the Canadian Fisheries Adjustment and Restructuring Program;
  - initiatives under the Canadian Opportunities Strategy, as announced in both the 1998 and 1999 budgets, including the introduction of the Canada Education Savings Grant and the Canada Jobs Fund, renewal of the Youth Employment Strategy, increased funding for the granting councils and the Canada Study Grants program, and an additional investment in the Canada Foundation for Innovation; and
  - other initiatives announced in the 1998 and 1999 budgets, including funding for *Gathering Strength* (the government's response to the Royal Commission on Aboriginal Peoples), for the Canada Television and Cable Production Fund, and for furthering international co-operation, among others.

- Expenditures related to Crown corporations were up $0.9 billion. This component includes appropriations to consolidated Crown corporations (those Crown corporations that rely on government funding as their principal source of revenue) and the annual profit and losses for enterprise Crown corporations. The increase was largely attributable to changes in the allowance for loan guarantees and borrowings of enterprise Crown corporations. In contrast, appropriations for consolidated Crown corporations were virtually unchanged from 1997-98.

- Operating and capital expenditures include the costs of defence, government administration and delivery of specific services to the public, such as:
  - health care to Aboriginals and veterans;
  - research undertaken by government departments;
  - food inspection;
  - Coast Guard and air and sea rescue;
  - operation of national parks and historic sites;
  - collection of taxes;
  - operation of federal correctional institutions and provision of police services; and
  - administration of programs.

Spending in this component declined $0.2 billion, or 0.6 per cent, from 1997-98.

Consistent with the difference between gross and net budgetary revenues, gross budgetary expenditures were $11.9 billion higher than net budgetary expenditures. The differences are described on page 10.

Table 3
Budgetary expenditures

	1997-98	1998-99	Net change	
		($ millions)		(%)
Net major transfers to persons				
Elderly benefits	22,225	22,781	556	2.5
Employment insurance benefits	11,842	11,884	42	0.4
Total	34,067	34,665	598	1.8
Major transfers to other levels of government				
Canada Health and Social Transfer (CHST)	12,612	12,528	-84	-0.7
CHST cash supplement		3,500	3,500	
Fiscal arrangements	10,000	11,645	1,645	16.5
Alternative Payments for Standing Programs	-2,108	-2,150	-42	-2.0
Total	20,504	25,523	5,019	24.5
Net direct program spending				
Subsidies and other transfers				
Agriculture and Agri-food	817	1,194	377	46.1
Foreign Affairs and International Trade	2,084	2,065	-19	-0.9
Health Canada	902	1,180	278	30.8
Human Resources Development	2,076	2,429	353	17.0
Indian Affairs and Northern Development	3,978	4,101	121	3.1
Industry/regional agencies	2,177	2,282	105	4.8
Veterans Affairs	1,374	1,377	3	0.2
One-time liabilities	5,450		-5,450	
Other	3,618	4,107	489	13.5
Total	22,476	18,735	-3,741	-16.6
Crown corporations				
Canada Mortgage and Housing Corporation	1,863	1,865	2	0.1
Canadian Broadcasting Corporation	806	912	106	13.2
Other	-121	720	841	n/a
Total	2,548	3,497	949	37.2
Operating and capital expenditures				
Defence	8,879	8,781	-98	-1.1
All other departments	20,279	20,192	-87	-0.4
Total	29,158	28,973	-185	-0.6
Net direct program spending	54,182	51,205	-2,977	-5.5
Net program spending	**108,753**	**111,393**	**2,640**	**2.4**
Public debt charges	40,931	41,394	463	1.1
Net budgetary expenditures	**149,684**	**152,787**	**3,103**	**2.1**
Adjustments				
Canada Child Tax Benefit	5,352	5,715	363	6.8
Old Age Security benefit repayment	-467	-496	-29	-6.2
Quarterly goods and services tax credit	2,892	2,850	-42	-1.5
Revenues netted against expenditures	2,196	2,305	109	5.0
Revenues of consolidated Crown corporations	1,227	1,498	271	22.1
Net adjustment	11,200	11,872	672	6.0
Gross budgetary expenditures	**160,884**	**164,659**	**3,775**	**2.3**

n/a.: not applicable

The Budgetary Balance, Financial Requirements/Surplus and Debt

The budgetary balance is presented on a modified accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made. The budgetary balance covers only those activities over which the government has legislative control.

In contrast, financial requirements/surplus measures the difference between cash coming in to the government and cash going out. It differs from the budgetary balance in that it includes transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, and changes in other financial assets and liabilities. These activities are included as part of non-budgetary transactions. The conversion from accrual to cash accounting is also reflected in non-budgetary transactions.

Non-budgetary transactions in 1998-99 resulted in a net source of funds amounting to $8.6 billion, down $0.7 billion from 1997-98. Among the major components:

- Loans, investments and advances were down $1.5 billion, primarily reflecting the impact of the change in accounting in 1997-98 for assistance to international financial institutions.
- Pensions and other accounts were up $3.2 billion. Of this amount, $1.2 billion was attributable to plan enhancements to the various public sector pension plans as specified in the *Budget Implementation Act, 1999*. The amendments improved pension entitlements primarily by calculating pension benefits using the average of the best five consecutive years of earnings rather than the best six consecutive years. These changes were part of the overall reform of the public sector pension plans, as announced by the President of the Treasury Board in February 1999. The costs of this reform were charged to pension expenditures in 1998-99.
- Other transactions were down $2.3 billion. In the 1998 budget, a number of one-time initiatives were announced and charged to program spending in 1997-98. However, as no cash payments with respect to these initiatives were made in 1997-98, an offsetting adjustment was made in other transactions. Cash payments with respect to these initiatives were made in 1998-99, which dampened the effect of the initiatives announced in the 1999 budget, for which no cash payments were made in 1998-99.

With a budgetary surplus of $2.9 billion and a net source of funds from non-budgetary transactions of $8.6 billion, there was a financial surplus, excluding foreign exchange transactions, of $11.5 billion in 1998-99, down slightly from the financial surplus of $12.7 billion in 1997-98. This marks the third consecutive year in which a financial surplus was recorded.

Foreign exchange transactions represent all transactions in international reserves held in the Exchange Fund Account. The purpose of the Exchange Fund Account is to promote order and stability of the Canadian dollar in the foreign exchange market. It fulfills this function by buying foreign exchange (selling Canadian dollars) when there is upward pressure on the value of the Canadian dollar and selling foreign exchange (buying Canadian dollars) when there is downward pressure. The buying of Canadian dollars represents a source of funds from exchange fund transactions, while the selling of Canadian dollars represents a requirement. Changes in foreign currency liabilities, which are undertaken to change the level of Canada's foreign exchange reserves, also impact on foreign exchange transactions. During 1998-99, foreign exchange transactions resulted in a net requirement of funds amounting to $5.7 billion, compared to a net requirement of $2.2 billion in 1997-98.

Table 4

Budgetary balance and financial requirements/surplus

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
			(billions of dollars)			
Budgetary balance	-42.0	-37.5	-28.6	-8.9	3.5	2.9
Non-budgetary transactions						
Loans, investments and advances	0.6	0.3	2.7	0.3	2.0	0.5
Pensions and other accounts						
Public sector pensions	6.2	6.9	6.8	6.3	3.3	5.0
Canada Pension Plan	-0.1	0.7	0.2	0.1	0.5	1.2
Other	0.2	1.0	0.6	0.5	0.1	0.9
Total	6.2	8.7	7.6	6.9	3.8	7.0
Other transactions	5.4	2.6	1.1	3.0	3.4	1.1
Total	12.2	11.6	11.4	10.2	9.3	8.6
Financial requirements/surplus (excluding foreign exchange transactions)	-29.8	-25.9	-17.2	1.3	12.7	11.5
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2	-5.7
Net financial balance	-32.0	-27.3	-21.9	-6.5	10.6	5.8
Net change in borrowings	31.2	27.0	28.5	7.3	-9.6	-6.9
Change in cash balances	-0.7	-0.2	6.7	0.8	1.0	-1.1
Cash in bank (March 31)	2.1	1.9	8.6	9.4	10.4	9.3

As a result, there was a net financial surplus – the budgetary surplus plus non-budgetary and foreign exchange transactions – of $5.8 billion in 1998-99, compared to a net financial surplus of $10.6 billion in 1997-98.

With this net financial surplus and a reduction in its cash balances of $1.1 billion, the government was able to retire $6.9 billion of its market debt. Cash balances at March 31, 1999 stood at $9.3 billion.

Total liabilities consist of interest-bearing debt and other liabilities. Interest-bearing debt includes unmatured debt and liabilities for pension and other accounts. At March 31, 1999, interest-bearing debt amounted to $595.0 billion, up slightly from a year earlier. Other liabilities, which include accounts payable and accrued liabilities, increased by $1.6 billion. As a result, total liabilities, or gross debt, stood at $640.3 billion.

Financial assets consist of cash and accounts receivable, foreign exchange accounts and loans, investments and advances. Capital assets, inventories and net receivables for tax revenues are not included. Capital assets and inventories are fully charged to expenditures at the time of acquisition or construction while tax revenues are reported on a cash basis. Financial assets totalled $63.5 billion at March 31, 1999, up $4.7 billion from March 31, 1998, attributable to increased assets in the foreign exchange accounts as the government continues to increase foreign exchange reserves to be more in line with other comparable countries.

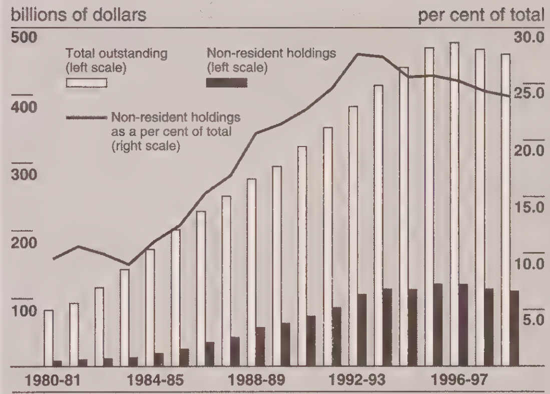
Table 5
Outstanding debt at year-end

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
			(billions of dollars)			
Interest-bearing debt						
Unmatured debt	414.0	441.0	469.5	476.9	467.3	460.4
Pension and other accounts	100.5	109.2	116.9	123.7	127.5	134.6
Total	514.5	550.2	586.4	600.6	594.8	595.0
Other liabilities	31.9	34.6	38.3	40.1	43.7	45.3
Total liabilities (gross debt)	546.4	584.8	624.7	640.7	638.5	640.3
Financial assets	38.2	39.1	50.4	57.5	58.8	63.5
Accumulated deficit (net public debt)	508.2	545.7	574.3	583.2	579.7	576.8

As a result, the accumulated deficit, or net public debt, stood at $576.8 billion at March 31, 1999, down $2.9 billion from March 31, 1998 and $6.4 billion below the peak of $583.2 billion at March 31, 1997.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $107.5 billion at the end of March 1999. This represented 23.3 per cent of the government's total market debt – the lowest ratio since 1990-91.

Foreign holdings of Government of Canada debt



Source: Bank of Canada.

The "Scorecard"

This section compares the outcome for selected economic indicators for 1998, and for the financial results for fiscal year 1998-99, with the forecasts presented in the February 1998 and 1999 budgets.

The government targeted a balanced budget for 1998-99 in both the 1998 and 1999 budgets. Under the Debt Repayment Plan, the fiscal target for each year is based on:

- prudent economic planning assumptions – the average of private sector economic forecasts available at that time adjusted to include an additional element of prudence; and
- the inclusion of an annual Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. For 1998-99, the Contingency Reserve was set at $3.0 billion.

1998 budget

Economic growth for 1998 was significantly weaker than assumed at the time of the 1998 budget, primarily reflecting the impact of the Asian financial crises. In contrast, interest rates turned out to be lower than those used for budget planning purposes.

Based on sensitivity analysis, the change in nominal income should have resulted in a deterioration in the revenue outcome for 1998-99, compared to the 1998 budget projections. However, positive revenue developments in the final quarter of 1997-98 – the results of which only became available after the tabling of the 1998 budget – carried over in 1998-99. As a result, budgetary revenues were $4.7 billion higher than forecast in the 1998 budget, with all major components up except excise taxes and duties. Public debt charges were $2.1 billion lower than projected in the 1998 budget, attributable in part to the lower-than-assumed outcome for interest rates and the lower stock of market debt.

The net impact of the higher revenues and lower public debt charges resulted in an improvement in the budgetary balance of $6.8 billion.

However, program spending was $6.9 billion higher than projected at the time of the 1998 budget. This was attributable to initiatives announced since the 1998 budget, which totalled $5.2 billion, and the impact of prior-year adjustments, which increased Equalization entitlements by $2.4 billion. In contrast, major transfers to persons were lower, primarily reflecting the impact of the lower-than-expected number of unemployed on employment insurance benefits.

The net impact of these developments was a requirement of $0.1 billion. As the balanced budget target for 1998-99 included a Contingency Reserve of $3 billion, there was a surplus of $2.9 billion. This surplus was applied to reducing the public debt, as specified under the Debt Repayment Plan.

Non-budgetary transactions were $2.6 billion higher than assumed in the 1998 budget. As a result, the financial surplus, excluding foreign exchange transactions, was $5.5 billion higher than projected in the 1998 budget.

1999 budget

Budgetary revenues for 1998-99 were $0.8 billion lower than projected in the 1999 budget, primarily due to transfers from personal income tax revenues to the Provincial Tax Collection Account, for underpayments with respect to both the 1997 and 1998 taxation years. Program spending was $0.7 billion lower, primarily due to lower direct program spending.

Non-budgetary transactions were $2.9 billion lower than assumed in the 1999 budget. As a result, the financial surplus, excluding foreign exchange transactions, was unchanged from the 1999 budget projection.

Table 6
The "scorecard": comparison of outcomes to 1998 and 1999 budget estimates

	Outcome: Difference from	
	1998 budget	1999 budget
Economic indicators (1998)		
Nominal GDP (percentage points)	-1.6	0.0
Interest rates		
91-day Treasury bill rate (basis points)	-68	-8
10-year government bond rate (%)	-110	0
Financial results (1998-99)	(billions of dollars)	
Budgetary revenues		
Personal income tax	1.5	-1.2
Corporate income tax	1.1	-0.4
Other income tax	0.6	0.0
Employment insurance premium revenues	0.8	0.2
Excise taxes and duties	-0.6	0.0
Non-tax revenues	1.2	0.4
Total	4.7	-0.8
Program spending		
Major transfers to persons		
Elderly benefits	-0.1	0.0
Employment insurance benefits	-0.7	-0.2
Major transfers to other levels of government		
Canada Health and Social Transfer	3.6	0.1
Fiscal arrangements	2.4	0.0
Direct program spending	1.5	-0.7
Total	6.9	-0.7
Public debt charges	-2.1	0.0
Net impact on budgetary balance	**-0.1**	**-0.1**
Contingency Reserve	-3.0	-3.0
Budgetary outcome	**2.9**	**2.9**
Non-budgetary transactions	2.6	-2.9
Financial requirements/surplus (excluding foreign exchange transactions)	5.5	0.0

OPINION OF THE AUDITOR GENERAL ON THE CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

To the Minister of Finance:

The accompanying condensed statements of revenues, expenditures and accumulated deficit, assets and liabilities and changes in financial position are derived from the complete financial statements of the Government of Canada as at March 31, 1999 and for the year then ended on which I expressed an opinion without reservation in my report dated July 26, 1999. This opinion also referred to my qualified opinion on the March 31, 1998 complete financial statements. The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria established by The Canadian Institute of Chartered Accountants.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and changes in financial position, reference should be made to the related complete financial statements to be included in Volume I of the 1999 *Public Accounts of Canada*, expected to be tabled in the House of Commons later this year.

L. Denis Desautels, FCA
Auditor General of Canada

Ottawa, Canada
July 26, 1999

Condensed Financial Statements of the Government of Canada

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs of the government and the resources for which it is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the government.

These financial statements are extracted and condensed from the audited financial statements included in Section 1 of Volume I of the 1999 *Public Accounts of Canada*, which are expected to be tabled in Parliament later this year. As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 7

Government of Canada
Condensed statement of revenues, expenditures and accumulated deficit for the year ended March 31, 1999

	1999	1998
	(millions of dollars)	
Revenues		
Tax revenues		
Income tax	102,183	101,142
Excise taxes and duties	34,249	33,752
Employment insurance premiums	19,363	18,802
	155,795	153,696
Non-tax revenues	11,748	10,666
Total gross revenues	***167,543***	***164,362***
Amounts deducted to arrive at net revenues	11,872	11,200
Total net revenues	***155,671***	***153,162***
Expenditures		
Transfer payments		
Old Age Security and related payments	22,285	21,758
Other levels of government	25,523	20,504
Employment insurance benefits	11,884	11,842
Other transfer payments	27,300	28,909
	86,992	83,013
Crown corporation expenditures	4,995	3,775
Other program expenditures	31,278	31,353
Total gross program expenditures	***123,265***	***118,141***
Amounts deducted to arrive at net program expenditures	11,872	11,200
Total net program expenditures	***111,393***	***106,941***
Interest on debt	41,394	40,931
Total net expenditures	***152,787***	***147,872***
Surplus for the year before change in accounting policy	**2,884**	**5,290**
Change in accounting policy		(1,812)
Surplus for the year	**2,884**	**3,478**
Accumulated deficit at beginning of year	579,708	583,186
Accumulated deficit at end of year	**576,824**	**579,708**

Table 8

Government of Canada
Condensed statement of assets and liabilities as at March 31, 1999

	1999	1998
	(millions of dollars)	
Liabilities		
Payables, accruals and allowances		
Accounts payable and accruals	34,300	32,783
Allowances for guarantees and employee benefits	11,016	10,917
	45,316	43,700
Interest-bearing debt		
Unmatured debt		
Marketable bonds	295,752	294,583
Treasury bills	96,950	112,300
Canada Savings Bonds	27,662	29,769
Bonds for Canada Pension Plan	4,063	3,456
Total payable in Canadian currency	424,427	440,108
Payable in foreign currencies	36,000	27,183
	460,427	467,291
Pension and other accounts		
Public sector pensions	122,407	117,457
Canada Pension Plan (net of securities)	5,427	4,205
Other	6,724	5,872
	134,558	127,534
Total interest-bearing debt	594,985	594,825
Total liabilities	***640,301***	***638,525***
Assets		
Cash and accounts receivable		
Cash	10,693	11,691
Accounts receivable	4,580	4,122
	15,273	15,813
Foreign exchange accounts	34,668	28,968
Loans, investments and advances		
Enterprise Crown corporations and other government business enterprises	11,052	12,601
National governments and international organizations	7,555	6,869
Other	4,341	3,832
	22,948	23,302
Less allowance for valuation	9,412	9,266
	13,536	14,036
Total assets	***63,477***	***58,817***
Accumulated deficit	**576,824**	**579,708**

Table 9

Government of Canada
Condensed statement of changes in financial position
for the year ended March 31, 1999

	1999	1998
	(millions of dollars)	
Cash provided by operating activities		
Surplus for the year	2,884	3,478
Add expenditures not requiring cash	11,466	13,867
	14,350	17,345
Net payments from pension and other accounts	(3,531)	(5,110)
Net change in receivables, payables and accruals	181	(470)
	11,000	11,765
Cash provided by investing activities		
Net decrease in loans, investments and advances	566	1,467
Cash provided by foreign exchange activities		
Net increase in foreign currency borrowings	8,817	4,167
Less net increase in foreign exchange accounts	5,700	2,155
	3,117	2,012
Net cash generated before financing activities	***14,683***	***15,244***
Cash used for financing activities		
Net decrease in Canadian currency borrowings	15,681	13,728
Net increase (decrease) in cash	**(998)**	**1,516**
Cash at beginning of year	11,691	10,175
Cash at end of year	***10,693***	***11,691***

Government of Canada
Notes to the Condensed Financial Statements

Significant accounting policies

The Government of Canada reporting entity includes all departments, agencies, corporations and funds which are owned or controlled by the government and which are accountable to Parliament. The financial activities of all these entities are consolidated in these statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the government for financing their activities. These corporations are reported as investments at their original cost adjusted by an allowance for valuation to reflect their annual profits or losses. The Canada Pension Plan is excluded from the reporting entity, as it is under the joint control of the government and participating provinces.

The government basically accounts for transactions on an accrual basis. Two notable exceptions are tax revenues and related refunds, which are generally accounted for on a cash basis; and capital assets, which are fully charged to expenditures at the time of acquisition or construction.

As a consequence, the only assets recorded on the Condensed Statement of Assets and Liabilities are financial assets, as they can provide resources to discharge liabilities or finance future operations. Assets are recorded at the lower of cost or net realizable value. Liabilities are recorded on an accrual basis with public sector pension and severance liabilities being determined on an actuarial basis. Valuation allowances are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable.

Comparative figures for 1998 are reclassified to conform to the current year's presentation, except for the one-time impact of the change made in 1998 of $1.8 billion in the accounting policy for assistance to international financial institutions.

Reporting of revenues and expenditures on a gross basis

Detailed amounts on the Condensed Statement of Revenues, Expenditures and Accumulated Deficit are presented on a full (gross) disclosure basis only. Gross revenues include revenues of consolidated Crown corporations, and revenues of government departments, agencies and funds which, on the net basis, are deducted from expenditures for budget and parliamentary authority purposes. Gross expenditures include expenditures determined through the tax system, such as child tax benefits and quarterly goods and services tax credits, that are deducted from revenues on the net basis.

Contractual commitments

Contractual commitments that will materially affect the level of future expenditures include transfer payment agreements, benefit plans for veterans and others, capital asset acquisitions and other purchases, operating and capital leases, and funding of international organizations. At March 31, 1999 contractual commitments amounted to approximately $30.9 billion ($29.4 billion in 1998).

Contingent liabilities

Contingent or potential liabilities that may become actual liabilities in future years include: guarantees by the government; callable share capital in international organizations; claims and pending and threatened litigation; and environmental contingencies. Contingent liabilities related to guarantees by the government and international organizations amount to $62 billion. The total amount claimed against the government for other claims and pending and threatened litigation but not assessed is not determinable. Of these other claims, over $200 billion relates to Aboriginal and comprehensive land claims. The government is confident that the ultimate settlement for these contingent liabilities will be for amounts significantly lower than those being disclosed.

Insurance in force relating to self-sustaining insurance programs operated for the government by three enterprise Crown corporations amounted to approximately $501 billion ($485 billion in 1998). The government expects that it will not incur any costs to cover the claims for these programs.

Other sources of information

The Public Accounts of Canada

The *Public Accounts of Canada*, as required under Section 64(1) of the *Financial Administration Act*, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in two volumes:

- Volume I contains the government's audited financial statements and supporting schedules and information; and
- Volume II contains details of financial operations by Ministry (Part I) and additional information and analyses (Part II).

The Budget

The budget, usually introduced in February, presents the government's overall fiscal plan, incorporating revenue projections and spending plans which combine to determine the resulting budgetary balance. The budget also introduces proposals for changes in taxation.

The Estimates

Each year, the government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board.

The Debt Management Report

This annual document provides an overview of the federal government's borrowing operations. It outlines the key elements of current federal debt strategy and describes various strategic and operational aspects of the government's debt program and cash management activities over the past fiscal year.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the government together with the reasons underlying major variances.

Government Publications

3

Annual Financial Report

of the Government of Canada

Fiscal Year 1999-2000

OCT 20 2000

Canada

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Annual Financial Report

of the Government of Canada

Fiscal Year 1999-2000

In the February 2000 budget, the Government committed to a balanced budget or better for 1999-2000. This was after setting aside a $3-billion Contingency Reserve in order to ensure that the fiscal target would be realized. It also included an allocation of $6.2 billion to key priorities for Canadians including: a $2.5-billion cash supplement under the Canada Health and Social Transfer for health and higher education; $1.3 billion for initiatives to make the economy more innovative, such as the $0.9 billion for the Canada Foundation for Innovation; $0.8 billion to meet Canada's international obligations; and funding to assist Canadian farmers.

As a result of a better than expected economic performance, budgetary revenues grew much more strongly in the last quarter of 1999-2000 than forecast in Budget 2000, while program spending was lower. As a result, for fiscal year 1999-2000, there was a budgetary surplus of $12.3 billion – $9.3 billion above the $3-billion Contingency Reserve. This surplus was applied to reducing the net public debt. This marks the third consecutive year in which the federal government has reported a budgetary surplus – the last time that this happened was in the late 1940s and early 1950s. As a result, the stock of net public debt has declined by $18.7 billion in just three years. Market debt – the debt issued on credit markets – fell even faster than net public debt. Over the last three fiscal years, $20.4 billion of market debt has been retired.

Department of Finance Canada · Ministère des Finances Canada

This large paydown of net public debt is welcome news. Canada's debt level is high, both by historical Canadian and international standards. A high debt burden means that a large portion of the revenue the Government collects from taxpayers must go towards debt servicing payments rather than to reduce taxes, to fund valued programs and services or to pay down the debt. Reducing the debt burden also lessens the exposure of the fiscal situation to economic shocks, especially an increase in interest rates or prolonged slowdowns in economic activity. And a lower debt burden ensures that younger Canadians do not pay an unduly large portion of the debt.

Net public debt as a percentage of the economy is now at 58.9 per cent, a decline of more than 12 percentage points from its peak of 71.2 per cent in 1995-96. On an international basis, Canada has made more progress in reducing its debt burden than any other G-7 country. Public debt charges now account for about 25 cents of each revenue dollar received – back to where it was in 1981-82, whereas in 1995-96 it amounted to 36 cents. The Debt Repayment Plan, coupled with sustained economic growth, will ensure that both the stock of debt and the debt burden continue to decline.

The better fiscal outcome is not unique to the federal government. Most provinces as well as other major industrialized nations are reporting much better than expected financial results for the fiscal year just ended.

The Auditor General of Canada, Denis Desautels, has expressed a "clean" opinion on these financial statements. As his term expires at the end of March 2001, these will be the last financial statements on which he will express an audit opinion. Although there have been on occasion differences in interpretation between the Auditor General and the Government, the dedication and professionalism brought to the office by Mr. Desautels are exemplary. Canadians and the Government have been extremely well served during his tenure. I wish him well in whatever new endeavour he pursues.

The 1998-99 edition of the *Annual Financial Report* included a user survey. The results regarding the content and organization of the report were generally very positive and the majority of respondents felt that there was a sufficient amount of information. I wish to thank all of those who responded.

The financial data in this report are based on the audited results, which will appear in more detail in the 2000 *Public Accounts of Canada*, scheduled for tabling in the House of Commons this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 1999–March 31, 2000) and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* have been updated to incorporate the results for 1999-2000 and historical revisions to the National Economic and Financial Accounts published by Statistics Canada. These tables are an integral part of this report.

The Honourable Paul Martin, P.C., M.P.
Minister of Finance

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Report Highlights

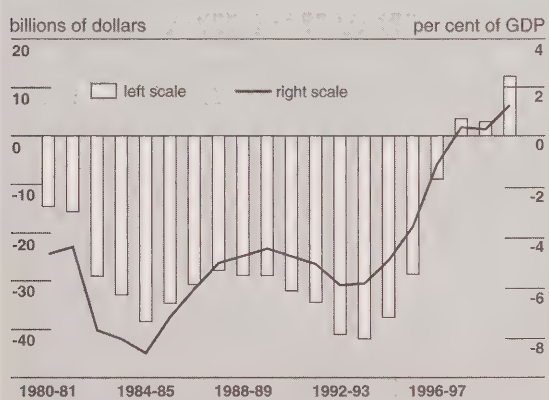
- Budgetary surplus of $12.3 billion in 1999-2000, following surpluses of $3.5 billion in 1997-98 and $2.9 billion in 1998-99. The last time the budget was in surplus for three consecutive years was 1951-52.
- By accounting practices used in most other countries, a financial source for the fourth consecutive year was reported – the only G-7 country to do so.
- Net public debt was down $18.7 billion from its peak in 1996-97 to stand at $564.5 billion. The net public debt-to-GDP ratio was down to 58.9 per cent from a peak of 71.2 per cent in 1995-96.
- Market debt – the debt issued on credit markets – fell even faster than net public debt. Over the last three fiscal years, $20.4 billion of market debt has been retired.

The Budgetary Balance

At the time of the February 1999 budget, private sector economists expected nominal income – a proxy for the federal tax base – to advance by only 2.7 per cent in 1999. However, this was revised up to 5.1 per cent in September 1999 and 5.4 per cent in the February 2000 budget.

The much stronger than expected growth in the economy resulted in much higher revenues and lower employment insurance benefits than forecast at the time of the February 1999 budget. At the time of the February 2000 budget, an underlying budgetary surplus of $9.2 billion was expected for 1999-2000. Of that amount, a $3-billion Contingency Reserve was maintained to ensure that the budgetary target of a balanced budget or better would be realized. That left a planning surplus after the Contingency Reserve of $6.2 billion. This surplus was allocated to a number of key priorities: a cash supplement of $2.5 billion to the Canada Health and Social Transfer was made available to help the provinces and territories fund post-secondary education and health care; $1.3 billion was directed to initiatives to make the economy more innovative, including the $0.9-billion transfer to the Canada Foundation for Innovation; another $0.8 billion was allocated to meet Canada's international obligations; and additional financial assistance was provided to Canadian farmers.

Budgetary Balance



Sources: Public Accounts of Canada and Statistics Canada.

However, data that became available after the 2000 budget indicated that nominal income growth averaged 6.2 per cent for 1999, and this strength continued into 2000. As a result, budgetary revenues were $5.8 billion higher than estimated in the February 2000 budget while expenditures were $3.5 billion lower. This, in combination with the $3-billion Contingency Reserve, resulted in a budgetary surplus for 1999-2000 of $12.3 billion – all of which has been applied to reducing the net public debt.

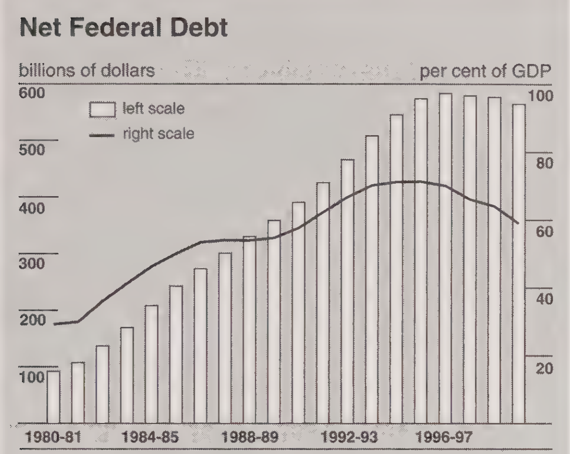
In 1993-94, the federal deficit stood at $42 billion. The actions taken in the 1994, 1995 and 1996 budgets, coupled with sustained economic growth, resulted in the elimination of that deficit in just four years.

Table 1
Financial Highlights

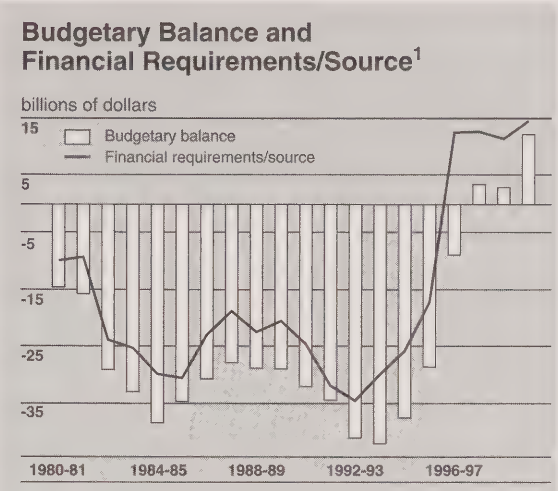
	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
				($ billions)			
Budgetary transactions							
Revenues	116.0	123.3	130.3	140.9	153.2	155.7	165.7
Program spending	-120.0	-118.7	-112.0	-104.8	-108.8	-111.4	-111.8
Operating balance	-4.0	4.6	18.3	36.1	44.4	44.3	53.9
Public debt charges	-38.0	-42.0	-46.9	-45.0	-40.9	-41.4	-41.6
Budgetary balance	**-42.0**	**-37.5**	**-28.6**	**-8.9**	**3.5**	**2.9**	**12.3**
Non-budgetary transactions	12.2	11.6	11.4	10.2	9.3	8.6	2.3
Net financial requirements/source (excludes foreign exchange transactions)	-29.9	-25.8	-17.2	1.3	12.7	11.5	14.6
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2	-5.7	-6.8
Total financial requirements/source	-32.0	-27.3	-21.9	-6.5	10.6	5.8	7.7
Net change in borrowings	31.2	27.0	28.5	7.3	-9.6	-6.9	-4.0
Net change in cash balances	-0.7	-0.2	6.7	0.8	1.0	-1.1	3.7
Financial position							
Total liabilities	-546.4	-584.8	-624.7	-640.7	-638.5	-640.3	-638.7
Total financial assets	38.2	39.1	50.4	57.5	58.8	63.5	74.2
Accumulated deficit (net public debt)	-508.2	-545.7	-574.3	-583.2	-579.7	-576.8	-564.5
Financial results (% of GDP)							
Budgetary revenues	16.0	16.1	16.1	16.9	17.4	17.3	17.3
Program spending	16.6	15.5	13.9	12.6	12.4	12.4	11.7
Public debt charges	5.2	5.5	5.8	5.4	4.7	4.6	4.3
Budgetary balance	-5.8	-4.9	-3.5	-1.1	0.4	0.3	1.3
Net public debt	70.1	71.1	71.2	70.0	66.0	64.0	58.9

In 1997-98, a budgetary surplus of $3.5 billion was recorded, the first surplus in 28 years. This was followed by surpluses of $2.9 billion in 1998-99 and $12.3 billion in 1999-2000.

This turnaround in the budgetary balance reflects the combined effects of lower program spending, primarily reflecting the expenditure reduction measures introduced since 1993, and higher revenues, primarily reflecting the growth in the economy. The contributions are best viewed in terms of their relationship to gross domestic product (GDP). Over the period 1993-94 to 1999-2000, there was an improvement of 7.1 percentage points of GDP in the budgetary balance – from a deficit of 5.8 per cent of GDP in 1993-94 to a surplus of 1.3 per cent of GDP in 1999-2000. Over two-thirds of this improvement is attributable to the decline in program spending – from 16.6 per cent of GDP in 1993-94 to 11.7 per cent of GDP in 1999-2000. Budgetary revenues increased by 1.3 percentage points of GDP – representing less than 20 per cent of the overall improvement in the budgetary balance, while public debt charges, as a per cent of GDP, declined by 0.9 of a percentage point, accounting for about 13 per cent of the improvement in the budgetary balance.



Sources: Public Accounts of Canada and Statistics Canada.



[1]Excluding foreign exchange transactions.
Source: Public Accounts of Canada.

Net Public Debt

The 1999-2000 surplus of $12.3 billion brings the federal government's net public debt – the accumulation of annual deficits and surpluses – down to $564.5 billion. As a share of GDP, the net public debt dropped to 58.9 per cent, down 12.3 percentage points from the peak of 71.2 per cent in 1995-96. The decline in the ratio in 1999-2000 is the largest since 1951-52. This ratio is generally recognized as the most appropriate indicator of the debt burden as it measures debt relative to the ability of the Government and the country's taxpayers to finance it. This is the fourth consecutive year in which the debt-to-GDP ratio has declined and this is the lowest ratio since 1990-91. The net public debt at the end of 1999-2000 was $18,408 for each Canadian, down from $18,972 a year earlier.

Net public debt consists of interest-bearing debt and other liabilities, net of financial assets. Interest-bearing debt, in turn, consists of unmatured, or market debt, and the Government's obligations to internally held accounts – primarily the liabilities for the federal government employees' pension plans.

- In 1999-2000, market debt declined by $4.0 billion to $456.4 billion. This reflected a smaller stock of marketable bonds, offset in part by a larger stock of Treasury bills. This brings the decline in market debt since 1996-97 to $20.4 billion.
- Overall, interest-bearing debt was $597.9 billion, up $2.9 billion from 1998-99, as the decline in market debt was more than offset by an increase of $6.9 billion in liabilities to public sector pensions and other accounts.

Financial Requirements/Source

Financial requirements/source measures the difference between cash coming in to the Government and cash going out. Most industrialized countries currently use a measure comparable to the financial requirements/source as their main budget measure.

- There was a financial source (excluding foreign exchange transactions) of $14.6 billion in 1999-2000 – the fourth consecutive year in which a financial source has been recorded – the only G-7 country to do so.

During the course of the fiscal year, there was a net requirement of $6.8 billion relating to foreign exchange transactions, up from a net requirement of $5.7 billion in 1998-99. Including these amounts, the financial source in total was $7.7 billion, up from a source of $5.8 billion in 1998-99.

BUDGETARY REVENUES

Table 2 on page 10 shows budgetary revenues on both a budget, or "net", basis and on a "gross" basis. The net figures reflect the way in which revenues and expenditures are presented to Parliament and in the Government's annual budget. On a gross basis, the tax expenditures netted against revenues are included as part of spending, while the items netted against spending are included as part of revenues, thereby increasing both revenues and spending with no impact on the budgetary balance.

Tax expenditures netted against revenues are:

- the Canada Child Tax Benefit (CCTB);
- the quarterly goods and services tax (GST) credit; and
- repayments of Old Age Security benefits.

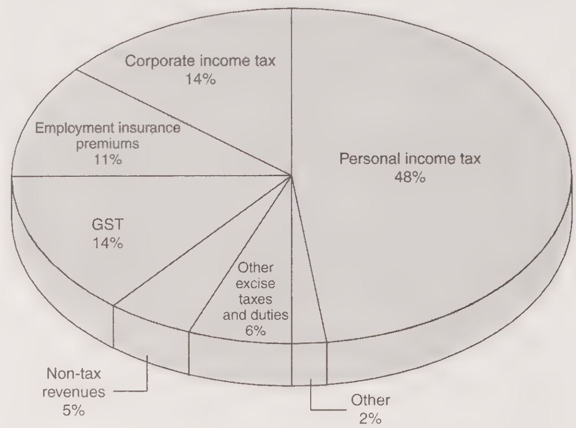
Departmental revenues netted against spending are:

- revenues of consolidated Crown corporations; and
- revenues levied by departments for specific services, such as the costs of policing services in provinces.

On a net basis, revenues grew strongly in 1999-2000 to $165.7 billion, an increase of $10.0 billion, or 6.4 per cent, from the 1998-99 level. In 1998-99, revenues increased by only $2.5 billion.

The revenue ratio – net budgetary revenues as a percentage of GDP – represents an approximate measure of the overall "tax burden" in that it compares the total of all revenues collected to the size of the economy. The revenue ratio stood at 17.3 per cent in 1999-2000, unchanged from 1998-99. However, as some important components of income subject to taxation are excluded from the Statistics Canada measure of GDP, such as capital gains and income from trusteed pension plans, this ratio overstates the tax burden. Therefore, caution should be exercised in interpreting this ratio.

Composition of Net Revenues for 1999-2000



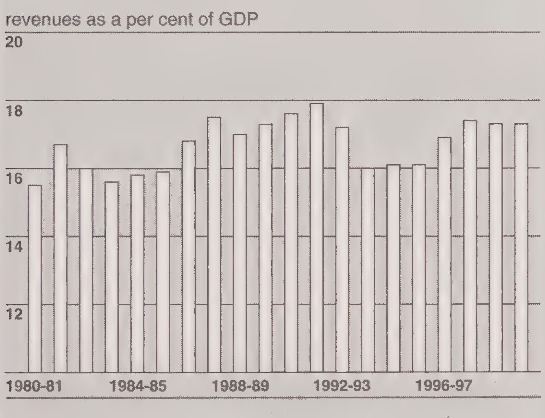
Source: Public Accounts of Canada.

Net personal income tax revenues, the largest component of budgetary revenues, were up $6.9 billion, or 9.5 per cent, in 1999-2000, accounting for more than two-thirds of the overall growth in revenues. This is in sharp contrast to the increase of only 2.4 per cent reported in 1998-99.

- Of this increase, about $3 billion, or about 40 per cent, reflected the impact of prior-year adjustments. Gross remittances received include not only federal personal income tax liabilities but also provincial income tax liabilities, as set out under the tax collection agreements with participating provinces, and employee and employer premium contributions for employment insurance and the Canada Pension Plan. On a monthly basis, deductions for these liabilities are based on estimates, with adjustments made once either preliminary or final data become available from the Canada Customs and Revenue Agency. In 1998-99, there were large transfers from personal income tax revenues, pertaining to under-estimations of these deductions during the course of the fiscal year. The reverse occurred in 1999-2000.

- Most of the remaining increase is attributable to the growth in the underlying tax base. According to Statistics Canada, wages and salaries, the largest component of the tax base, increased by 5.1 per cent in 1999, up from an increase of 4.7 per cent in 1998. This increase reflected both a strong gain in the number of people employed, up 2.8 per cent from 1998, and increases in average wages and salaries. In addition, Statistics Canada's definition of personal income excludes some important income components subject to taxation, such as capital gains and income from trusteed pension plans, which have outpaced the growth in personal income in recent years.
- Dampening the impact of these factors were higher refunds pertaining to the 1998 taxation year, up $1.9 billion from 1998-99, in part reflecting fewer refunds processed in March 1999, and the impact of tax reduction initiatives introduced in the 1998 and 1999 budgets. General tax relief measures, such as an increase in the amount of income that Canadians can receive on a tax-free basis, the elimination of the general federal surtax and increases in the CCTB are estimated to have reduced personal income tax revenues by an incremental $3.0 billion in 1999-2000.

Revenue Ratio



Sources: Department of Finance and Statistics Canada.

Corporate income tax revenues increased $1.6 billion in 1999-2000, or 7.4 per cent, reversing the decline of 4.1 per cent in 1998-99. After declining 5.6 per cent in 1998, corporate profits rebounded strongly in 1999, increasing by nearly 24 per cent. However, the application of prior-year losses and higher refunds pertaining to the lower profits in 1998 restrained the net increase in corporate income tax revenues in 1999-2000. Other income tax revenues, which closely mirror the performance of corporate profits, were up $0.6 billion, or 20.6 per cent.

Employment insurance premium revenues declined $0.9 billion, or 4.4 per cent, in 1999-2000.

- The employee premium rate (per $100 of insurable earnings) was reduced from $2.70 for 1998 to $2.55 for 1999 and to $2.40 for 2000 (with a corresponding decline in the employer rate). The net impact of these rate reductions was to lower revenues by about $1.5 billion in 1999-2000.
- Net transfers relating to prior-year adjustments were lower in 1999-2000 than in 1998-99, resulting in an incremental decline of about $0.4 billion.
- Significantly dampening the effect of these factors was the strong increase in the number of people employed.

Net excise taxes and duties increased $1.5 billion, or 4.7 per cent, up from a gain of only 1.7 per cent recorded in 1998-99. However, there were significant variations among the various components.

- Virtually all of the year-over-year increase occurred in net GST revenues, up $2.1 billion, or 10.2 per cent. Consumer expenditures on durable goods and new homes were up sharply in 1999.
- Customs import duties declined 10.8 per cent, reflecting the reductions in tariffs, as specified under international agreements.

- Other excise taxes and duties were down 4.4 per cent, due primarily to the elimination of the air transportation tax effective November 1, 1998.

Net non-tax revenues increased $0.3 billion, or 4.0 per cent, in 1999-2000, primarily reflecting gains from the foreign exchange accounts, increased recoveries and higher revenues from the sale of broadcasting licences.

Gross budgetary revenues in 1999-2000 were $12.4 billion higher than net budgetary revenues of which: $6.0 billion was for the CCTB, $2.9 billion for the quarterly GST tax credit, $1.4 billion for revenues of consolidated Crown corporations and $2.6 billion for revenues levied by departments, which are credited back to the programs giving rise to these revenues. The increase in the CCTB payments was attributable to the increase in benefits announced in the 1998 budget.

Table 2

Budgetary Revenues

	1998-99	1999-00	Net Change	
		($ millions)		(%)
Net income tax collections				
Personal income tax	72,488	79,378	6,890	9.5
Corporate income tax	21,575	23,170	1,595	7.4
Other	2,901	3,499	598	20.6
Total	96,964	106,047	9,083	9.4
Employment insurance premium revenues	19,363	18,512	-851	-4.4
Net excise taxes and duties				
Goods and services tax (GST)	20,684	22,790	2,106	10.2
Customs import duties	2,359	2,105	-254	-10.8
Other excise taxes/duties				
Energy taxes	4,716	4,757	41	0.9
Other	3,640	3,234	-406	-11.2
Total	8,356	7,991	-365	-4.4
Total	31,399	32,886	1,486	4.7
Net tax revenues	147,726	157,445	9,719	6.6
Net non-tax revenues				
Return on investments	4,991	5,251	260	5.2
Other non-tax revenues	2,954	3,012	58	2.0
Total	7,945	8,263	318	4.0
Net budgetary revenues	**155,671**	**165,708**	**10,037**	**6.4**
Adjustments				
Canada Child Tax Benefit	5,715	6,000	285	5.0
Old Age Security benefit repayment	-496	-554	-58	11.7
Quarterly GST credit	2,850	2,920	70	2.5
Revenues netted against expenditures	2,305	2,625	320	13.9
Revenues of consolidated Crown corporations	1,498	1,391	-107	-7.1
Net adjustment	11,872	12,382	510	4.3
Gross budgetary revenues	**167,543**	**178,090**	**10,547**	**6.3**

BUDGETARY EXPENDITURES

Table 3 on page 15 presents budgetary expenditures on both a gross and net basis. The differences are identical to those between gross and net budgetary revenues.

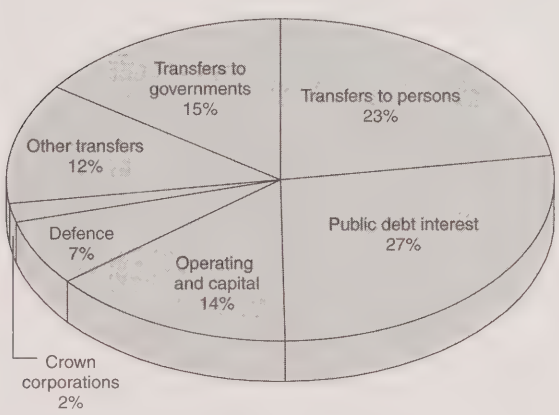
Net budgetary expenditures amounted to $153.4 billion in 1999-2000, up $0.6 billion, or 0.4 per cent, from 1998-99. The "expenditure ratio" – net budgetary expenditures as a percentage of net budgetary revenues – stood at 92.6 per cent in 1999-2000, down from 98.1 per cent in 1998-99. In 1993-94, the expenditure ratio stood at 136.2 per cent.

Public debt charges increased by $0.3 billion, or 0.6 per cent, in 1999-2000. They are affected by interest rate developments as well as by the stock and composition of interest-bearing debt.

- The average effective interest rate on the Government's interest-bearing debt (unmatured debt and pension liabilities) was 7.4 per cent in 1999-2000, unchanged from 1998-99. The average effective interest rate on unmatured debt was 6.7 per cent, while that on pension and other accounts was 9.6 per cent. Since 1989-90, the average effective interest rate on interest-bearing debt has declined by 3.5 percentage points, with virtually all of this attributable to lower average effective interest rates on unmatured debt – down 4.5 percentage points.
- The stock of total interest-bearing debt increased slightly in 1999-2000, from $595.0 billion to $597.9 billion. However, the stock of market debt declined by $4.0 billion to $456.4 billion, while the liabilities to pension and other accounts increased by $6.9 billion to $141.5 billion. Since 1993-94, the share of market debt has declined by about 4 percentage points with a corresponding increase in the liabilities for pension and other accounts. Within market debt, the share of marketable bonds has increased by about 20 percentage points, while that for Treasury bills and Canada Savings Bonds has declined.

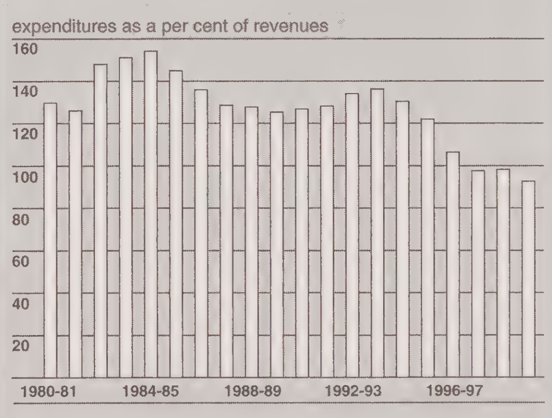
The interest ratio – public debt charges as a percentage of net budgetary revenues – declined from 26.6 per cent in 1998-99 to 25.1 per cent in 1999-2000. This ratio means that, in 1999-2000, the Government spent about 25 cents of every revenue dollar on interest on the public debt. This is down from the peak of 36 cents in 1995-96 and is the lowest ratio since 1981-82. This is money that must be paid to meet the Government's obligations on its debt. The lower the ratio, the more flexibility the Government has to address the key priorities of Canadians.

Composition of Net Expenditures for 1999-2000

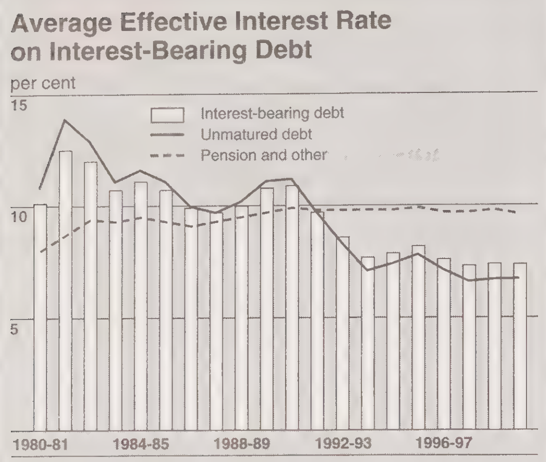


Source: Public Accounts of Canada.

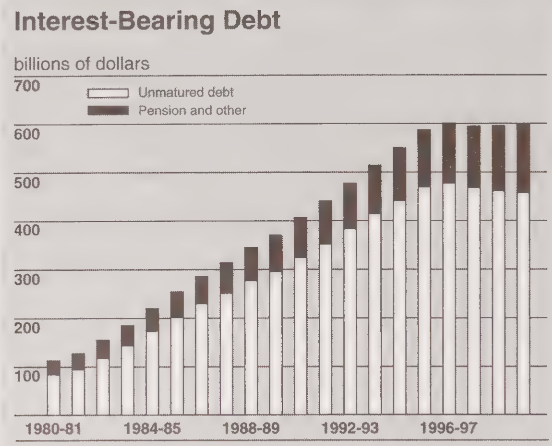
Expenditure Ratio



Source: Public Accounts of Canada.



Source: Public Accounts of Canada.



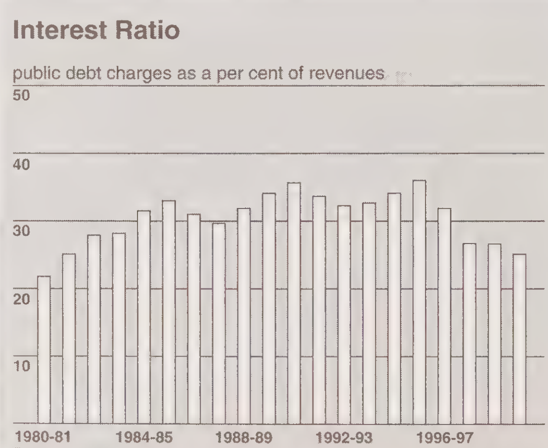
Source: Public Accounts of Canada.

Net program spending – net budgetary expenditures less public debt charges – increased $0.4 billion, or 0.3 per cent, in 1999-2000. The program share – net program spending as a percentage of net budgetary revenues – amounted to 67.4 per cent, down from 71.6 per cent in 1998-99. In 1993-94, the program share was 103.5 per cent.

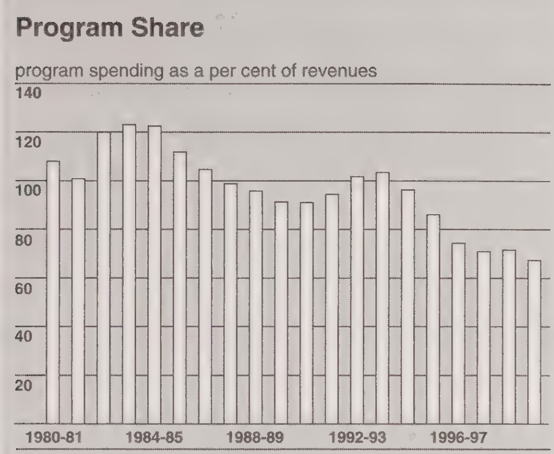
Within program spending, major transfer payments to persons, consisting of elderly benefits and employment insurance benefits, increased marginally, up $46 million, or 0.1 per cent.

- Elderly benefits consist of Old Age Security payments, Guaranteed Income Supplement payments and spouse's allowance payments. Total benefits were up $629 million in 1999-2000, reflecting both higher average benefits, which are indexed to inflation, and an increase in the number of recipients.
- Employment insurance benefits declined $583 million, or 4.9 per cent, in 1999-2000. Regular benefit payments were $0.7 billion lower, reflecting the decline in the number of unemployed. In contrast, transfers to the provinces under the Labour Market Development Agreements and payments under special benefits, such as sickness, maternity and parental benefits, were slightly higher.

Major transfer payments to other levels of government include the Canada Health and Social Transfer (CHST), fiscal arrangements (Equalization, transfers to the territories, as well as a number of small transfer programs) and Alternative Payments for Standing Programs. Net cash transfers declined by $2.3 billion in 1999-2000, or 8.9 per cent. However, all of this decline was attributable to a lower CHST cash supplement in 1999-2000 than in 1998-99 and the inclusion of large prior-year Equalization entitlements in 1998-99.



Source: Public Accounts of Canada.



Source: Public Accounts of Canada.

- The CHST – a block-funded transfer – supports health care, post-secondary education, social assistance and social services. It provides support in the form of cash and tax transfers to the provinces and territories. In the 1998 budget, the cash floor was increased from $11 billion to $12.5 billion.
- In the 1999 budget, the Government announced a special payment of $3.5 billion to be paid to a third-party trust to be drawn by the provinces and territories for health care needs over a period of three years. This supplement was charged to the 1998-99 fiscal year. In the 2000 budget, the Government announced another special payment, this time of $2.5 billion. This payment was also made to a third-party trust to be drawn by the provinces and territories for post-secondary education and health care over a period of four years. This supplement was charged to the 1999-2000 fiscal year.
- Equalization is the largest of the transfers under fiscal arrangements. Under the Equalization program, the federal government transfers funds to the less prosperous provinces so that they can provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

  In 1998-99, tax data for previous taxation years indicated much stronger revenue gains in the non-Equalization receiving provinces than in the Equalization-receiving provinces, thereby resulting in large retroactive entitlement adjustments in 1998-99. In the absence of these adjustments, payments in 1999-2000 would have increased roughly in line with the growth in nominal income.
- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allow provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provides provinces with tax points, the value of which are netted against total entitlements, and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Direct program spending – total program spending less major transfers to persons and other levels of government – consists of subsidies and other transfer payments, expenditures related to Crown corporations, defence spending, and operating and capital expenditures of non-defence departments and agencies. Spending in this component amounted to $53.8 billion in 1999-2000, up $2.6 billion, or 5.1 per cent, from 1998-99. This increase was entirely attributable to the impact of the initiatives announced in the 2000 budget, which totalled $3.4 billion.

Within direct program spending:

- Subsidies and other transfer payments declined by $0.2 billion, or 1.1 per cent, as the ending of the special transitional assistance programs to fishers and plant workers affected by the East Coast groundfish crisis, lower spending on labour market programs, reduced liabilities against loans outstanding and the ending of transitional assistance to NAV CANADA associated with the transfer of air navigational services more than offset the impact of new initiatives announced in Budget 2000.

The latter included:

- $900 million to the Canada Foundation for Innovation (CFI) to award funds to help post-secondary educational institutions, research hospitals and not-for-profit institutions modernize their research infrastructure. This brings the Government's total transfer to the CFI to $1.9 billion.
- $160 million to Genome Canada to fund the activities of five genome science centres.
- $100 million to create a revolving fund – the Green Municipal Investment Fund – to support projects in areas such as energy and water savings, urban transit and waste diversion.
- $60 million to fund the Canadian Foundation for Climate and Atmospheric Sciences.
- $586 million for income disaster assistance to help Canadian farmers.

• Expenditures related to Crown corporations were down $0.5 billion, or 15.6 per cent, from 1998-99. This component includes appropriations to consolidated Crown corporations (those Crown corporations that rely on government funding as their principal source of revenue) and the annual profit and losses for enterprise Crown corporations. The decline was largely attributable to the increase in net profits of enterprise Crown corporations.

• Operating and capital expenditures include the costs of defence, government administration and delivery of specific services to the public, such as:
  - health care to Aboriginals and veterans;
  - research undertaken by government departments;
  - food inspection;
  - Coast Guard and air and sea rescue;
  - operation of national parks and historic sites;
  - collection of taxes;
  - operation of federal correctional institutions and provision of police services; and
  - administration of programs.

Spending in this component increased $3.3 billion, or 11.6 per cent, from 1998-99. Of this amount:

• Defence spending increased $1.4 billion, primarily attributable to increased funding to assist the military in meeting Canada's international commitments in Kosovo. In addition, the 1999 budget provided funding to address compensation and benefit pressures.

• Non-defence departmental operating and capital spending increased $1.9 billion. About half of this increase was attributable to the increased employee benefit costs in large part associated with the resumption of collective bargaining after six years of legislative wage restraint. In addition, during the fiscal year, the Treasury Board Secretariat conducted a major review of the capacity of a number of government departments to deliver existing programs. This review resulted in an increase in funding of about $500 million in a limited number of areas that were considered as essential to the health and safety of Canadians and to the sustainability of quality public services. Most of this incremental funding was directed to Citizenship and Immigration Canada, the Royal Canadian Mounted Police and Fisheries and Oceans Canada.

Consistent with the difference between gross and net budgetary revenues, gross budgetary expenditures were $12.4 billion higher than net budgetary expenditures. The differences are described in the section on budgetary revenues.

Table 3

Budgetary Expenditures

	1998-99	1999-00	Net Change	
		($ millions)		(%)
Net major transfers to persons				
Elderly benefits	22,781	23,410	629	2.8
Employment insurance benefits	11,884	11,301	-583	-4.9
Total	34,665	34,711	46	0.1
Major transfers to other levels of government				
Canada Health and Social Transfer (CHST)	12,500	12,500	0	0.0
Fiscal arrangements	10,398	10,721	323	3.1
Alternative Payments for Standing Programs	-2,150	-2,425	-275	12.8
Subtotal	20,748	20,796	48	0.2
Special payments:				
CHST cash supplement	3,500	2,500	-1,000	-28.6
Prior-year adjustments				
CHST	28	-109		
Fiscal arrangements	1,247			
Other		56		
Total	25,523	23,243	-2,280	-8.9
Net direct program spending				
Subsidies and other transfers				
Agriculture and Agri-food	1,194	1,518	324	27.1
Foreign Affairs and International Trade	2,065	2,114	49	2.4
Health Canada	1,180	1,161	-19	-1.6
Human Resources Development	2,429	2,008	-421	-17.3
Indian Affairs and Northern Development	4,101	4,185	84	2.0
Industry/regional agencies	2,282	2,971	689	30.2
Veterans Affairs	1,377	1,402	25	1.8
Other	4,107	3,176	-931	-22.7
Total	18,735	18,535	-200	-1.1
Crown corporations				
Canada Mortgage and Housing Corporation	1,865	1,928	63	3.4
Canadian Broadcasting Corporation	912	879	-33	-3.6
Other	720	146	-574	-79.7
Total	3,497	2,953	-544	-15.6
Operating and capital expenditures				
Defence	8,781	10,201	1,420	16.2
All other departments	20,192	22,120	1,928	9.5
Total	28,973	32,321	3,348	11.6
Net direct program spending	51,205	53,809	2,604	5.1
Net program spending	**111,393**	**111,763**	**370**	**0.3**
Public debt charges	41,394	41,647	253	0.6
Net budgetary expenditures	**152,787**	**153,410**	**623**	**0.4**
Adjustments				
Canada Child Tax Benefit	5,715	6,000	285	5.0
Old Age Security benefit repayment	-496	-554	-58	11.7
Quarterly goods and services tax credit	2,850	2,920	70	2.5
Revenues netted against expenditures	2,305	2,625	320	13.9
Revenues of consolidated Crown corporations	1,498	1,391	-107	-7.1
Net adjustment	11,872	12,382	510	4.3
Gross budgetary expenditures	**164,659**	**165,792**	**1,133**	**0.7**

The Budgetary Balance, Financial Requirements/Source and Debt

The budgetary balance is the most comprehensive measure of the federal government's fiscal results. It is presented on a modified accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made. The budgetary balance covers only those activities over which the Government has legislative control.

In contrast, financial requirements/source measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance in that it includes transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, and changes in other financial assets and liabilities. These activities are included as part of non-budgetary transactions. The conversion from accrual to cash accounting is also reflected in non-budgetary transactions.

Non-budgetary transactions in 1999-2000 resulted in a net source of funds amounting to $2.3 billion, down from a net source of $8.6 billion in 1998-99. Among the major components:

- Loans, investments and advances recorded a net requirement of $0.3 billion, compared to a net source of $0.5 billion in 1998-99.
- Pensions and other accounts, at $7.0 billion, were unchanged from 1998-99.
- Other transactions recorded a net requirement of $4.4 billion, compared to a net source of $1.1 billion in 1998-99.

With a budgetary surplus of $12.3 billion and a net source of funds from non-budgetary transactions of $2.3 billion, there was a net financial source, excluding foreign exchange transactions, of $14.6 billion in 1999-2000, up from the financial source of $11.5 billion in 1998-99. This marks the fourth consecutive year in which a financial source was recorded.

Total financial requirements/source includes foreign exchange transactions. Foreign exchange transactions represent all transactions in international reserves held in the Exchange Fund Account. The purpose of the Exchange Fund Account is to promote order and stability of the Canadian dollar in the foreign exchange market. It fulfills this function by buying foreign exchange (selling Canadian dollars) when there is upward pressure on the value of the Canadian dollar and selling foreign exchange (buying Canadian dollars) when there is downward pressure. The buying of Canadian dollars represents a source of funds from exchange fund transactions, while the selling of Canadian dollars represents a requirement. Changes in foreign currency liabilities, which are undertaken to change the level of Canada's foreign exchange reserves, also impact on foreign exchange transactions. During 1999-2000, foreign exchange transactions resulted in a net requirement of funds amounting to $6.8 billion, compared to a net requirement of $5.7 billion in 1998-99.

As a result, there was a total financial source – the budgetary surplus plus non-budgetary and foreign exchange transactions – of $7.7 billion in 1999-2000, compared to a source of $5.8 billion in 1998-99.

With this total financial source, the Government retired $4.0 billion of its market debt and increased its cash balances by $3.7 billion. Cash balances at March 31, 2000, stood at $13.0 billion.

Total liabilities consist of interest-bearing debt and other liabilities. Interest-bearing debt includes market debt and liabilities for pension and other accounts. At March 31, 2000, interest-bearing debt amounted to $597.9 billion, up slightly from the level a year earlier. Other liabilities, which include accounts payable and accrued liabilities, amounted to $40.7 billion, down $4.6 billion from 1998-99. As a result, total liabilities, or gross debt, stood at $638.7 billion.

Table 4
Budgetary Balance and Financial Requirements/Source

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
				($ billions)			
Budgetary balance	-42.0	-37.5	-28.6	-8.9	3.5	2.9	12.3
Non-budgetary transactions							
Loans, investments and advances	0.6	0.3	2.7	0.3	2.0	0.5	-0.3
Pensions and other accounts							
Public sector pensions (net)	6.2	6.9	6.8	6.3	3.3	5.0	5.9
Canada Pension Plan	-0.1	0.7	0.2	0.1	0.5	1.2	0.8
Other	0.2	1.0	0.6	0.5	0.1	0.9	0.2
Total	6.2	8.7	7.6	6.9	3.8	7.0	7.0
Other transactions	5.4	2.6	1.1	3.0	3.4	1.1	-4.4
Total	12.2	11.6	11.4	10.2	9.3	8.6	2.3
Net financial requirements/source (excluding foreign exchange transactions)	-29.9	-25.8	-17.2	1.3	12.7	11.5	14.6
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2	-5.7	-6.8
Total financial balance	-32.0	-27.3	-21.9	-6.5	10.6	5.8	7.7
Net change in borrowings	31.2	27.0	28.5	7.3	-9.6	-6.9	-4.0
Change in cash balances	-0.7	-0.2	6.7	0.8	1.0	-1.1	3.7
Cash in bank (March 31)	2.1	1.9	8.6	9.4	10.4	9.3	13.0

Table 5
Outstanding Debt at Year-End

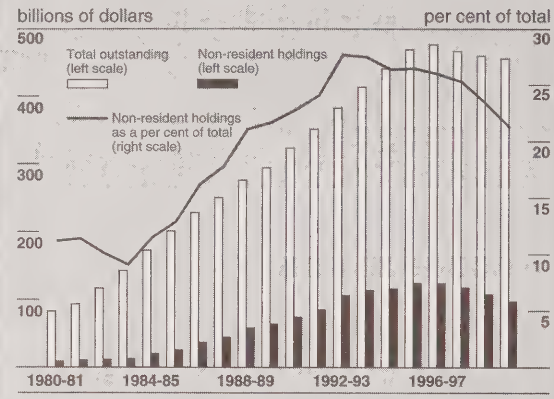
	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
				($ billions)			
Interest-bearing debt							
Unmatured debt	414.0	441.0	469.5	476.9	467.3	460.4	456.4
Pension and other accounts	100.5	109.2	116.8	123.7	127.5	134.6	141.5
Total	514.5	550.2	586.4	600.6	594.8	595.0	597.9
Other liabilities	31.9	34.6	38.3	40.1	43.7	45.3	40.7
Total liabilities (gross debt)	546.4	584.8	624.7	640.7	638.5	640.3	638.7
Financial assets	38.2	39.1	50.4	57.5	58.8	63.5	74.2
Accumulated deficit (net public debt)	508.2	545.7	574.3	583.2	579.7	576.8	564.5

Financial assets consist of cash and accounts receivable, foreign exchange accounts and loans, investments and advances. Capital assets, inventories and net receivables for tax revenues are not included. Capital assets and inventories are fully charged to expenditures at the time of acquisition or construction while tax revenues are reported on a cash basis. Financial assets totalled $74.2 billion at March 31, 2000, up $10.7 billion from March 31, 1999, primarily attributable to higher cash balances at year-end and increased assets in the foreign exchange accounts as the Government continued to increase foreign exchange reserves to be more in line with other comparable countries.

As a result, the accumulated deficit, or net public debt, stood at $564.5 billion at March 31, 2000, down $12.3 billion from March 31, 1999, and $18.7 billion below the peak of $583.2 billion at March 31, 1997.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $97.3 billion at the end of March 2000. This represented 21.3 per cent of the Government's total market debt – the lowest ratio since 1988-89.

Foreign Holdings of Government of Canada Debt



Source: Bank of Canada.

The "Scorecard"

This section compares the outcome for selected economic indicators for 1999 and the outcome for the financial results for 1999-2000 with the forecasts presented in the February 2000 budget. It also provides a comparison with the February 1999 budget forecasts for 1999-2000.

The Government targeted a balanced budget for 1999-2000 in both the 1999 and 2000 budgets. Under the Debt Repayment Plan, the fiscal target for each year is based on:

- Using the average of private sector economic forecasts for budget planning purposes.
- Including an annual Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. It is not a source of funding for new policy initiatives. If not needed, it is used to pay down the public debt. For 1999-2000, the Contingency Reserve was set at $3 billion; and
- Adding an extra degree of economic prudence to provide further assurance against falling back into deficit. In the 1999 budget, this prudence was included in the revenue and expenditure projections through adjustments to the economic assumptions. As a result, its fiscal impact was not explicitly identified. In the 2000 budget, this extra prudence is explicitly shown.

Economic growth for 1999 was significantly stronger than expected at the time of the 1999 budget. Nominal income growth, based on the average of private sector forecasts adjusted for prudence, was projected at only 2.6 per cent for 1999. With deteriorating global economic prospects during 1998, related to the Asian financial crisis, most private sector economists had become pessimistic about Canada's growth prospects. However, economic conditions improved throughout 1999 and by the time of the November 2 *Economic and Fiscal Update*, private sector economists had revised their growth forecast for 1999 to 5.1 per cent. In the 2000 budget, it was further revised up to 5.4 per cent. Preliminary estimates from Statistics Canada, which were released in late May 2000, suggest that nominal income growth in 1999 averaged 6.2 per cent, more than double the rate expected at the time of the 1999 budget. In contrast, interest rates were little changed from those assumed at the time of the 1999 budget.

Comparison of 1999-2000 Outcome With 2000 Budget Estimates

In comparison to the 2000 budget projections, budgetary revenues were $5.8 billion higher. Personal income tax revenues were $2.9 billion higher, with about $1 billion related to recoveries from the tax collection agreement account. Non-tax revenues were $1.1 billion higher while excise taxes and duties were $0.9 billion higher. Program spending was $3.7 billion lower with direct program spending accounting for $3.1 billion. The lower than expected level of direct program spending was attributable to higher net profits from Crown enterprises and lower than assumed year-end liabilities. Public debt charges were $0.1 billion higher. As the balanced budget target for 1999-2000 included a Contingency Reserve of $3 billion, the overall budgetary surplus was $12.3 billion.

Non-budgetary transactions were $5.7 billion lower than assumed in the 2000 budget. As a result, the financial source, excluding foreign exchange transactions, was $6.5 billion higher than assumed in the 2000 budget.

Comparison of 1999-2000 Outcome With 1999 Budget Estimates

In comparison to the 1999 budget projections, budgetary revenues were $9.0 billion higher, with all major components being higher. The largest changes were in personal income tax revenues (up $4.4 billion) and corporate income tax revenues (up $2.3 billion). Adjustments related to prior years account for about $1 billion of the increase in personal income tax revenues.

Table 6

The "Scorecard": Comparison of Outcomes to 2000 and 1999 Budget Estimates

	Outcome: Difference From	
	2000 Budget	1999 Budget
Economic indicators (1999)		
Nominal GDP (percentage points)	0.8	3.6
Interest rates		
91-day Treasury bill rate (basis points)	2	-38
10-year government bond rate (basis points)	5	-5
Financial results (1999-2000)	($ billions)	
Budgetary revenues		
Personal income tax	2.9	4.4
Corporate income tax	0.7	2.3
Other income tax	0.2	0.6
Employment insurance premium revenues	0.0	0.2
Excise taxes and duties	0.9	0.6
Non-tax revenues	1.1	0.8
Total	5.8	9.0
Program spending		
Major transfers to persons		
Elderly benefits	0.1	-0.1
Employment insurance benefits	-0.4	-2.1
Major transfers to other levels of government		
Canada Health and Social Transfer	0.0	2.5
Fiscal arrangements	-0.3	0.5
Direct program spending	-3.1	-0.1
Total	-3.7	0.6
Public debt charges	0.1	-0.9
Contingency Reserve	-3.0	-3.0
Budgetary outcome	**12.3**	**12.3**
Non-budgetary transactions	-5.7	-2.7
Financial requirements/source (excluding foreign exchange transactions)	6.5	9.5

Total budgetary expenditures were $0.3 billion lower than forecast in the 1999 budget, with higher program spending (up $0.6 billion) being more than offset by lower public debt charges (down $0.9 billion). Within program spending, employment insurance benefits were $2.1 billion lower, primarily reflecting a lower than expected number of unemployed. Transfers to other levels of government were $3.0 billion higher, primarily reflecting the Budget 2000 $2.5-billion CHST cash supplement and higher Equalization entitlements. Direct program spending was slightly lower, as the impact of the new initiatives announced in Budget 2000 totalling $3.4 billion (see Annex 1 of *The Budget Plan 2000*) was more than offset by higher net profits from enterprise Crown corporations and lower than expected liabilities.

These developments resulted in a surplus of $9.3 billion in 1999-2000. The Contingency Reserve of $3 billion was not required, resulting in an overall budgetary surplus of $12.3 billion in the budgetary outcome.

Non-budgetary transactions were $2.7 billion lower than assumed in the 1999 budget. As a result, the financial source, excluding foreign exchange transactions, was $9.5 billion higher than assumed in the 1999 budget.

Opinion of the Auditor General on the Condensed Financial Statements of the Government of Canada

To the Minister of Finance:

The accompanying condensed statements of revenues, expenditures and accumulated deficit, assets and liabilities and changes in financial position are derived from the complete financial statements of the Government of Canada as at March 31, 2000 and for the year then ended on which I expressed an opinion without reservation in my report dated July 24, 2000. The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria established by The Canadian Institute of Chartered Accountants.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and changes in financial position, reference should be made to the related complete financial statements to be included in Volume I of the 2000 *Public Accounts of Canada*, expected to be tabled in the House of Commons later this year.

L. Denis Desautels, FCA
Auditor General of Canada

Ottawa, Canada
July 24, 2000

Condensed Financial Statements of the Government of Canada

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs and the resources for which the Government is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the Government.

These financial statements are extracted and condensed from the audited financial statements included in Section 1 of Volume I of the 2000 *Public Accounts of Canada*, which are expected to be tabled in Parliament later this year. As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 7

Government of Canada
Condensed Statement of Revenues, Expenditures and Accumulated Deficit for the Year Ended March 31, 2000

	2000	1999
	($ millions)	
Revenues		
Tax revenues		
Income tax	111,493	102,183
Excise taxes and duties	35,806	34,249
Employment insurance premiums	18,512	19,363
	165,811	155,795
Non-tax revenues	12,279	11,748
Total gross revenues	***178,090***	***167,543***
Amounts deducted to arrive at net revenues	12,382	11,872
Total net revenues	***165,708***	***155,671***
Expenditures		
Transfer payments		
Old Age Security and related payments	22,856	22,285
Other levels of government	23,243	25,523
Employment insurance benefits	11,301	11,884
Other transfer payments	27,455	27,300
	84,855	86,992
Crown corporation expenditures	4,344	4,995
Other program expenditures	34,946	31,278
Total gross program expenditures	***124,145***	***123,265***
Amounts deducted to arrive at net program expenditures	12,382	11,872
Total net program expenditures	***111,763***	***111,393***
Interest on debt	41,647	41,394
Total net expenditures	***153,410***	***152,787***
Surplus for the year	**12,298**	**2,884**
Accumulated deficit at beginning of year	576,824	579,708
Accumulated deficit at end of year	**564,526**	**576,824**

Table 8

Government of Canada Condensed Statement of Assets and Liabilities as at March 31, 2000

	2000	1999
	($ millions)	
Liabilities		
Payables, accruals and allowances		
Accounts payable and accruals	28,904	34,300
Allowances for guarantees and employee benefits	11,844	11,016
Total	40,748	45,316
Interest-bearing debt		
Unmatured debt		
Marketable bonds	293,927	295,752
Treasury bills	99,850	96,950
Canada Savings Bonds	26,489	27,662
Non-marketable bonds and notes	3,552	4,063
Total payable in Canadian currency	423,818	424,427
Payable in foreign currencies	32,588	36,000
Total	456,406	460,427
Pension and other accounts		
Public sector pensions	128,346	122,407
Due to Canada Pension Plan	6,217	5,427
Other	6,963	6,724
Total	141,526	134,558
Total interest-bearing debt	597,932	594,985
Total liabilities	***638,680***	***640,301***
Assets		
Cash and accounts receivable		
Cash	14,511	10,693
Accounts receivable	4,353	4,580
Total	18,864	15,273
Foreign exchange accounts	41,494	34,668
Loans, investments and advances		
Enterprise Crown corporations and other government business enterprises	10,562	11,052
National governments and international organizations	7,316	7,555
Other	4,184	4,341
Total	22,062	22,948
Less allowance for valuation	8,266	9,412
Total	13,796	13,536
Total assets	***74,154***	***63,477***
Accumulated deficit	**564,526**	**576,824**

Table 9

Government of Canada
Condensed Statement of Changes in Financial Position
for the Year Ended March 31, 2000

	2000	1999
	($ millions)	
Cash provided by operating activities		
Surplus for the year	12,298	2,884
Add expenditures not requiring cash	8,510	11,016
	20,808	13,900
Net payments from pension and other accounts	(4,010)	(3,081)
Net change in receivables, payables and accruals	(3,272)	181
	13,526	11,000
Cash provided by investing activities		
Net decrease in loans, investments and advances	1,139	566
Cash provided by foreign exchange activities		
Net increase in foreign currency borrowings	(3,412)	8,817
Net increase in foreign exchange accounts	(6,826)	(5,700)
	(10,238)	3,117
Net cash generated before financing activities	***4,427***	***14,683***
Cash used for financing activities		
Net decrease in Canadian currency borrowings	609	15,681
Net increase (decrease) in cash	**3,818**	**(998)**
Cash at beginning of year	10,693	11,691
Cash at end of year	***14,511***	***10,693***

Government of Canada
Notes to the Condensed Financial Statements

Significant Accounting Policies

The Government of Canada reporting entity includes all departments, agencies, corporations and funds which are owned or controlled by the Government and which are accountable to Parliament. The financial activities of all these entities are consolidated in these statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the Government for financing their activities. These corporations are reported as investments at their original cost adjusted by an allowance for valuation to reflect their annual profits or losses. The Canada Pension Plan is excluded from the reporting entity, as it is under the joint control of the Government and participating provinces.

The Government basically accounts for transactions on an accrual basis. Two notable exceptions are tax revenues and related refunds, which are generally accounted for on a cash basis; and capital assets, which are fully charged to expenditures at the time of acquisition or construction.

As a consequence, the only assets recorded on the Condensed Statement of Assets and Liabilities are financial assets, as they can provide resources to discharge liabilities or finance future operations. Assets are recorded at the lower of cost or net realizable value. Liabilities are recorded on an accrual basis with public sector pension and severance liabilities being determined on an actuarial basis. Valuation allowances are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the Government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable.

Comparative figures for 1999 are reclassified to conform to the current year's presentation.

Reporting of Revenues and Expenditures on a Gross Basis

Detailed amounts on the Condensed Statement of Revenues, Expenditures and Accumulated Deficit are presented on a full (gross) disclosure basis only. Gross revenues include revenues of consolidated Crown corporations and revenues of government departments, agencies and funds which, on the net basis, are deducted from expenditures for budget and parliamentary authority purposes. Gross expenditures include expenditures determined through the tax system, such as child tax benefits and quarterly GST credits, that are deducted from revenues on the net basis.

Contractual Commitments

Contractual commitments that will materially affect the level of future expenditures include transfer payment agreements; benefit plans for veterans and others; capital asset acquisitions and other purchases; operating and capital leases; and funding of international organizations. At March 31, 2000, contractual commitments amounted to approximately $33 billion ($31 billion in 1999).

Contingent Liabilities

Contingent or potential liabilities that may become actual liabilities in future years include guarantees by the Government; callable share capital in international organizations; claims and pending and threatened litigation; and environmental contingencies. Contingent liabilities related to guarantees by the Government and to international organizations amount to $67 billion ($62 billion in 1999). The total amount claimed against the Government for other claims and pending and threatened litigation but not assessed is not determinable. Of these other claims, over $200 billion relates to Aboriginal and comprehensive land claims. The Government is confident that the ultimate settlement for these contingent liabilities will be for amounts significantly lower than those being disclosed.

Insurance in force relating to self-sustaining insurance programs operated for the Government by three enterprise Crown corporations amounted to approximately $555 billion ($522 billion in 1999). The Government expects that it will not incur any costs to cover the claims for these programs.

Other Sources of Information

The Public Accounts of Canada

The *Public Accounts of Canada*, as required under Section 64(1) of the *Financial Administration Act*, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in two volumes:

- Volume I contains the Government's audited financial statements and supporting schedules and information; and
- Volume II contains details of financial operations by ministry (Part I) and additional information and analyses (Part II).

The Budget

The budget, usually introduced in February, presents the Government's overall fiscal plan, incorporating revenue projections and spending plans, which combine to determine the resulting budgetary balance. The budget also introduces proposals for changes in taxation.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the Government together with the reasons underlying major variances.

Debt Management Strategy

This report is tabled annually in Parliament. It provides information on the federal government's debt management strategy for the coming fiscal year.

The Debt Management Report

This annual document provides an accounting of the key elements of federal debt strategy and describes various strategic and operational aspects of the Government's debt program and cash management activities over the past fiscal year.

The Estimates

Each year, the Government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board and consists of three parts:

Part I – The Government Expenditure Plan provides an overview of federal spending and summarizes the relationship of the key elements of the Main Estimates to the Expenditure Plan set out in the budget.

Part II – The Main Estimates directly support the *Appropriations Act*.

Part III – Departmental Expenditure Plans, which consist of two components – Reports on Plans and Priorities and Departmental Performance Reports.

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Annual Financial Report

of the Government of Canada

Fiscal Year 2000–2001

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Annual Financial Report

of the Government of Canada

Fiscal Year 2000–2001

A budgetary surplus of $17.1 billion was recorded in 2000-01. This marks the fourth consecutive year in which the federal government has recorded a surplus – the last time this occurred was in the period up to 1951-52. The outcome for 2000-01 was significantly higher than what was expected in the February 2000 budget and October 2000 *Economic Statement and Budget Update*, reflecting substantially stronger economic growth than had been anticipated. Nominal income – the applicable tax base for revenues – advanced by 8.3 per cent in 2000, following a gain of 6.5 per cent in the previous year. With much slower economic growth expected in 2001, surpluses will be correspondingly lower.

As a result of the budgetary surpluses recorded to date, net public debt stood at $547.4 billion on March 31, 2001, down $35.8 billion from its peak of $583.2 billion in 1996-97. This large paydown in net public debt is important for a variety of reasons. Canada's debt level is high, both by historical Canadian and international standards. A high debt burden means that a large portion of the revenue the Government collects from taxpayers must go towards debt-servicing payments rather than to reduce taxes, to fund valued programs and services or to pay down the debt. Reducing the debt burden also lessens the exposure of the fiscal framework to economic shocks, especially an increase in interest rates or prolonged slowdowns in economic activity.

Department of Finance Canada | Ministère des Finances Canada

And a lower debt burden reduces the amount that younger Canadians have to pay for servicing debt incurred by the generations that preceded them. The reduction in debt has resulted in ongoing net interest savings of about $2.5 billion each and every year. This is the real fiscal dividend.

Net public debt as a percentage of the economy is now 51.8 per cent, a reduction of almost 19 percentage points from its peak of 70.7 per cent in 1995-96. On an international basis, Canada has made more progress in reducing its debt burden than any other G-7 country.

The financial data in this report are based on the audited results, which will appear in more detail in the 2001 *Public Accounts of Canada*, scheduled for tabling in the House of Commons this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 2000 to March 31, 2001) and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* have been updated to incorporate the results for 2000-01 and historical revisions to the National Economic and Financial Accounts published by Statistics Canada. These tables are an integral part of this report.

This is the final year in which the federal government's financial statements will be presented on a modified accrual basis of accounting. For 2001-02 the financial statements will be presented on a full accrual basis of accounting at year-end.

The Honourable Paul Martin, P.C., M.P.
Minister of Finance

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Report Highlights

- Budgetary surplus of $17.1 billion in 2000-01, following surpluses of $3.5 billion in 1997-98, $2.9 billion in 1998-99 and $12.3 billion in 1999-2000. The last time the budget was in surplus for four consecutive years was in the period up to 1951-52.
- As a result, net public debt is down $35.8 billion from its peak of $583.2 billion in 1996-97 to stand at $547.4 billion. The net public debt-to-GDP ratio is down to 51.8 per cent from a peak of 70.7 per cent in 1995-96.
- Market debt – the debt issued on credit markets – has declined by $30.4 billion since 1996-97. As a percentage of GDP, the ratio declined to 42.7 per cent, down from the peak of 57.8 per cent in 1995-96. Foreign holdings declined to 20.8 per cent of market debt – its lowest ratio since 1987-88.
- Program spending as a percentage of GDP declined to 11.3 per cent, down from 11.5 per cent in 1999-2000. The final outcome for 2000-01 was $0.4 billion lower than estimated in the October 2000 *Economic Statement and Budget Update.*
- Public debt charges as a percentage of revenues declined to 23.6 per cent in 2000-01, down from its peak of 36 per cent in 1995-96, and is now at its lowest ratio since 1981-82.
- By accounting practices used in most other countries, Canada reported a financial source for the fifth consecutive year – the only G-7 country to do so.

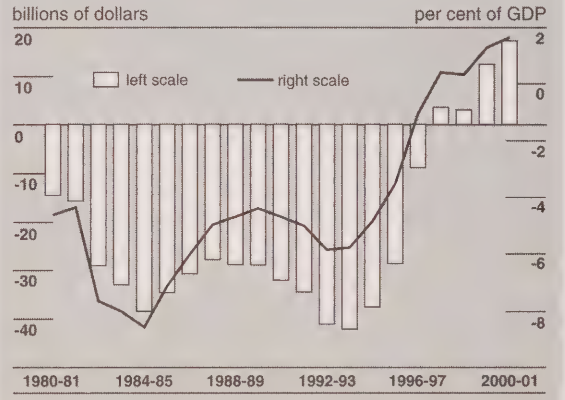
The Budgetary Balance

Economic growth was exceptionally strong in 2000, extending the rapid gains made in 1999. Nominal income – a proxy for the federal tax base – rose by 8.3 per cent, following an increase of 6.5 per cent in 1999. As part of planning for the February 2000 budget, private sector economists had expected nominal income to advance by only 5.7 per cent in 2000. This was revised up to 8.0 per cent in the October 2000 *Economic Statement and Budget Update*.

In the October 2000 *Economic Statement and Budget Update*, the underlying surplus for 2000-01 was revised up to $15.2 billion, reflecting the impact of the much stronger than forecast economic growth on federal revenues. This was after accounting for the costs associated with the September 2000 Agreements on Health Renewal and Early Childhood Development and proposed enhancements to the employment insurance program. These costs amounted to $1.8 billion in 2000-01.

In the October 2000 *Economic Statement and Budget Update*, the Government added a new element to its Debt Repayment Plan. In addition to the practice of setting aside $3 billion as a Contingency Reserve (which, if not needed, is applied to reducing the debt), it indicated that, each fall, it would announce whether a greater amount should be dedicated to that year's debt paydown. With an underlying surplus of $15.2 billion, the Government committed a minimum of $10 billion to debt reduction.

Budgetary Balance



Sources: Public Accounts of Canada and Statistics Canada.

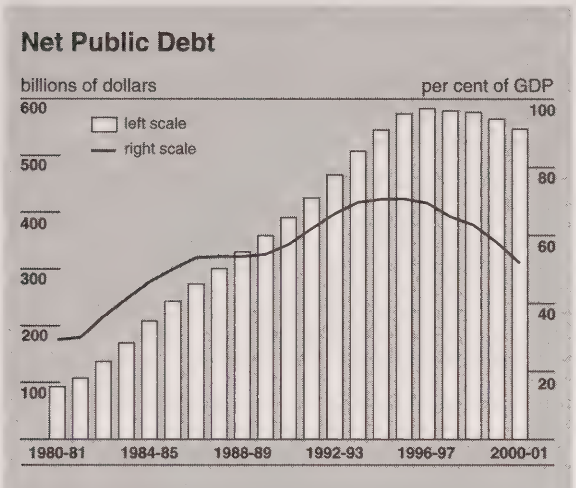
Table 1
Financial Highlights

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
				($ billions)				
Budgetary transactions								
Revenues	116.0	123.3	130.3	140.9	153.2	155.7	165.7	178.6
Program spending	-120.0	-118.7	-112.0	-104.8	-108.8	-111.4	-111.8	-119.3
Operating balance	-4.0	4.6	18.3	36.1	44.4	44.3	53.9	59.2
Public debt charges	-38.0	-42.0	-46.9	-45.0	-40.9	-41.4	-41.6	-42.1
Budgetary balance	**-42.0**	**-37.5**	**-28.6**	**-8.9**	**3.5**	**2.9**	**12.3**	**17.1**
Non-budgetary transactions	12.2	11.6	11.4	10.2	9.3	8.6	2.3	1.8
Financial requirements/source (excludes foreign exchange transactions)	-29.9	-25.8	-17.2	1.3	12.7	11.5	14.6	19.0
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2	-5.7	-6.8	-8.8
Total financial requirements/ source	-32.0	-27.3	-21.9	-6.5	10.6	5.8	7.7	10.2
Change in borrowings	31.2	27.0	28.5	7.3	-9.6	-6.9	-4.0	-10.0
Change in cash balances	-0.7	-0.2	6.7	0.8	1.0	-1.1	3.7	0.2
Financial position								
Total liabilities	-546.4	-584.8	-624.7	-640.7	-638.5	-640.3	-638.7	-632.9
Total financial assets	38.2	39.1	50.4	57.5	58.8	63.5	74.2	85.5
Accumulated deficit (net public debt)	-508.2	-545.7	-574.3	-583.2	-579.7	-576.8	-564.5	-547.4
Financial results (% of GDP)								
Budgetary revenues	15.9	16.0	16.0	16.8	17.3	17.0	17.0	16.9
Program spending	16.4	15.4	13.8	12.5	12.3	12.2	11.5	11.3
Public debt charges	5.2	5.4	5.8	5.4	4.6	4.5	4.3	4.0
Budgetary balance	-5.8	-4.8	-3.5	-1.1	0.4	0.3	1.3	1.6
Net public debt	69.7	70.6	70.7	69.5	65.5	63.0	57.9	51.8

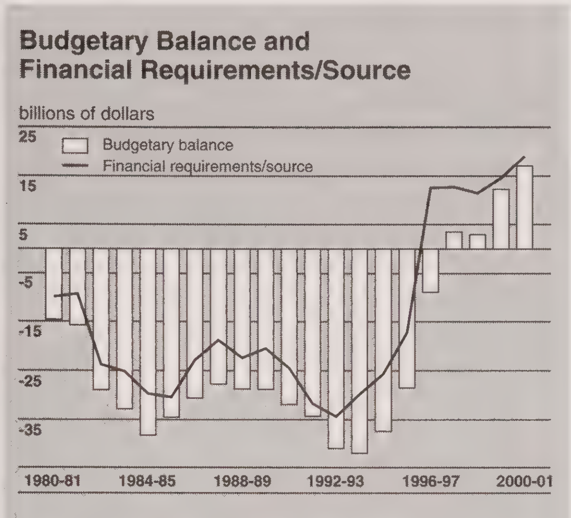
The remaining balance of $5.2 billion was allocated as follows: $1.3 billion for relief for higher heating expenses, $1.4 billion for tax reductions effective on January 1, 2001, and $500 million for the Canada Foundation for Innovation, leaving $1.9 billion unallocated, to be used for either further debt reduction, tax cuts or increased spending in priority areas.

In the May 2001 *Economic Update* the Government indicated that the surplus for 2000-01 would be at least $15 billion, based on the financial results available at that time. This outcome included the impact of a number of initiatives undertaken between the October 2000 *Economic Statement and Budget Update* and the end of the 2000-01 fiscal year. These initiatives totalled $2.1 billion and included incremental funding of $750 million for the Canada Foundation for Innovation, $500 million for agricultural assistance, $140 million for Genome Canada and $624 million for defence.

The final budgetary surplus for 2000-01 was $17.1 billion. All of this has been applied to reducing the net public debt. This represents an improvement of $4.8 billion from the surplus recorded in 1999-2000.



Sources: Public Accounts of Canada and Statistics Canada.



Note: Excludes foreign exchange transactions.
Source: Public Accounts of Canada.

Over the period 1993-94 to 2000-01, the budgetary balance as a percentage of gross domestic product (GDP) went from a deficit of 5.8 per cent of GDP in 1993-94 ($42 billion) to a surplus of 1.6 per cent of GDP in 2000-01 ($17.1 billion). Nearly 70 per cent of this improvement is attributable to the decline in program spending – from 16.4 per cent of GDP in 1993-94 to 11.3 per cent of GDP in 2000-01. Of the remaining improvement, public debt charges declined by 1.2 percentage points, while budgetary revenues increased by 1.0 percentage point. Program spending in 2000-01, at $119.3 billion, was $0.7 billion lower than its level of $120.0 billion in 1993-94.

Net Public Debt

The 2000-01 surplus of $17.1 billion brings the federal government's net public debt – the accumulation of annual deficits and surpluses – down to $547.4 billion from its peak of $583.2 billion in 1996-97. As a share of GDP, the net public debt dropped to 51.8 per cent, down 18.9 percentage points from the peak of 70.7 per cent in 1995-96. This ratio is generally recognized as the most appropriate indicator of the debt burden as it measures debt relative to the ability of the Government and the country's taxpayers to finance it.

This is the fifth consecutive year in which the debt-to-GDP ratio has declined and this is the lowest the ratio has been since 1985-86.

Net public debt consists of interest-bearing debt and other liabilities, net of financial assets. Interest-bearing debt, in turn, consists of unmatured, or market, debt and the Government's obligations to internally held accounts – primarily the liabilities for the federal government employees' pension plans. In 2000-01 market debt declined by $10.0 billion to $446.4 billion, primarily reflecting lower holdings of Treasury bills. This brings the decline in market debt since 1996-97 to $30.4 billion. Total interest-bearing debt was $589.2 billion, down $8.7 billion from 1999-2000, as the decline in market debt was dampened by an increase of $1.3 billion in liabilities to public sector pensions and other accounts.

Financial Requirements/Source

Financial requirements/source measures the difference between cash coming in to the Government and cash going out. Most industrialized countries use a measure comparable to the financial requirements/source as their main measure of the budgetary balance. There was a financial source (excluding foreign exchange transactions) of $19.0 billion in 2000-01 – the fifth consecutive year Canada has recorded a financial source – the only G-7 country to do so.

During the course of the fiscal year, there was a net requirement of $8.8 billion relating to foreign exchange transactions, up from a net requirement of $6.8 billion in 1999-2000. Including this amount, the financial source in total was $10.2 billion, up from a source of $7.7 billion in 1999-2000.

BUDGETARY REVENUES

Table 2 on page 11 shows budgetary revenues on both a budget, or "net," basis and "gross" basis. The net figures reflect the way in which revenues and expenditures are presented to Parliament and in the Government's annual budget. On a gross basis, the tax expenditures netted against revenues are included as part of spending while the items netted against spending are included as part of revenues, thereby increasing both revenues and spending with no impact on the budgetary balance.

Tax expenditures netted against revenues are:

- the Canada Child Tax Benefit;
- the quarterly goods and services tax (GST) credit; and
- repayments of Old Age Security benefits.

Departmental revenues netted against spending are:

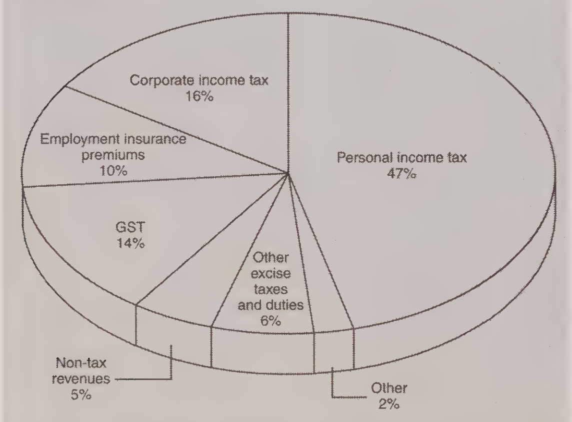
- revenues of consolidated Crown corporations; and
- revenues levied by departments for specific services, such as the costs of policing services in provinces.

The revenue ratio – net budgetary revenues as a percentage of GDP – represents an approximate measure of the overall "tax burden" in that it compares the total of all revenues collected to the size of the economy. The revenue ratio stood at 16.9 per cent in 2000-01, down slightly from 1999-2000. It should be noted that as some important components of income subject to taxation are excluded from the Statistics Canada measure of GDP, such as capital gains and income from trusteed pension plans, this ratio overstates the tax burden. In addition, the sharp rise in capital gains and the growth in income from trusteed pension plans due to the aging of the population distort year-to-year changes in the ratio. Therefore, caution should be exercised in interpreting this ratio.

On a net basis revenues grew strongly in 2000-01 to $178.6 billion, an increase of $12.9 billion, or 7.8 per cent, from 1999-2000. Corporate income taxes accounted for about 40 per cent of this increase.

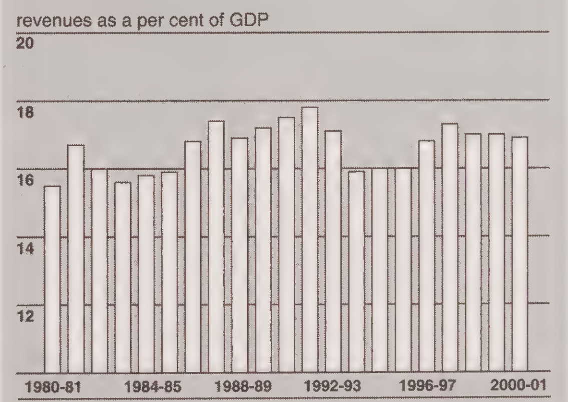
Personal income tax revenues, the largest component of budgetary revenues, were up $2.9 billion, or 3.7 per cent, in 2000-01, primarily reflecting the growth in the economy.

Composition of Net Revenues for 2000-01



Source: Public Accounts of Canada.

Revenue Ratio



Sources: Department of Finance and Statistics Canada.

This increase was substantially below the increase of $6.9 billion recorded in the previous fiscal year and the increase of 6.1 per cent in personal income – the proxy tax base for personal income tax revenues – recorded in 2000.

- However, about $3 billion of the increase reported in 1999-2000 was due to the impact of prior-year adjustments. Gross remittances received include not only federal personal income tax liabilities but also provincial income tax liabilities, as set out under the tax collection agreements with participating provinces, and employee and employer premium contributions for employment insurance and the Canada Pension Plan. On a monthly basis, estimates are made, with adjustments once either preliminary or final data become available from the Canada Customs and Revenue Agency. In 1999-2000 there were large transfers to personal income tax revenues, pertaining to over-estimations of these liabilities for previous fiscal years. There were no significant prior-year adjustments affecting the 2000-01 results.
- Another factor dampening the growth in personal income tax revenues in 2000-01 was an increase of $0.8 billion in the Canada Child Tax Benefit, reflecting enrichments announced in previous budgets.
- Adjusting for the impact of these factors, the underlying increase in personal income tax revenues was 5.3 per cent, slightly below the estimated increase in personal income. Normally, the growth in personal income tax revenues would somewhat exceed the increase in personal income. However, tax reductions announced in the February 2000 budget and October 2000 *Economic Statement and Budget Update*, as part of the Government's Five-Year Tax Reduction Plan, served to reduce the overall increase in personal income tax revenues. These measures included reductions in the tax rates, increases in income thresholds, full restoration of indexation and elimination of the 5-per-cent surtax.

Corporate income tax revenues increased $5.0 billion in 2000-01, or 21.8 per cent. This reflected the continued strong increase in corporate profits, up about 22 per cent in 2000.

Other income tax revenues, which closely mirror corporate profits, were up $0.8 billion, or 23.2 per cent.

Employment insurance premium revenues increased by $0.2 billion, or 1.2 per cent, in 2000-01. This reflected the effect of the strong increase in the number of people employed, largely offset by the reductions in premium rates. The employee premium rate (per $100 of insurable earnings) was reduced from $2.55 for 1999 to $2.40 for 2000 and to $2.25 for 2001 (with a corresponding decline in the employer rate).

Net excise taxes and duties increased $3.2 billion, or 9.8 per cent. However, there were significant variations among the various components.

- GST revenues were up $2.2 billion, or 9.7 per cent, virtually identical to the increase reported in the previous fiscal year. Consumer expenditures continued to grow strongly in 2000.
- Customs import duties increased $0.7 billion, or 33.3 per cent, following two years of decline. This increase reflected the strong advance in imports while the declines in each of the previous two years were primarily due to the reductions in tariffs, as specified under international agreements.
- Other excise taxes and duties were up 4.1 per cent.

Net non-tax revenues increased $0.7 billion, or 7.9 per cent, in 2000-01, primarily reflecting gains from the foreign exchange accounts, Bank of Canada profits and interest on bank balances.

Gross budgetary revenues in 2000-01 were $13.8 billion higher than net budgetary revenues, an increase of $1.5 billion from 1999-2000. This primarily reflected higher Canada Child Tax Benefit payments, attributable to the increase in benefits announced in recent budgets.

Table 2

Budgetary Revenues

	1999-00	2000-01	Net Change	
		($ millions)		(%)
Net income tax collections				
Personal income tax	79,378	82,305	2,927	3.7
Corporate income tax	23,170	28,212	5,042	21.8
Other	3,499	4,312	813	23.2
Total	106,047	114,829	8,782	8.3
Employment insurance premium revenues	18,512	18,731	219	1.2
Net excise taxes and duties				
Goods and services tax (GST)	22,790	24,990	2,200	9.7
Customs import duties	2,105	2,807	702	33.3
Other excise taxes/duties				
Energy taxes	4,757	4,805	48	1.0
Other	3,234	3,514	280	8.7
Total	7,991	8,319	328	4.1
Total	32,886	36,116	3,230	9.8
Net tax revenues	157,445	169,676	12,231	7.8
Net non-tax revenues				
Return on investments	5,251	6,144	893	17.0
Other non-tax revenues	3,012	2,770	-242	-8.0
Total	8,263	8,914	651	7.9
Net budgetary revenues	**165,708**	**178,590**	**12,882**	**7.8**
Adjustments				
Canada Child Tax Benefit	6,000	6,811	811	13.5
Old Age Security benefit repayment	-554	-588	-34	6.2
Quarterly GST credit	2,847	2,901	54	1.9
Revenues netted against expenditures	2,625	2,874	249	9.5
Revenues of consolidated Crown corporations	1,391	1,762	371	26.7
Net adjustment	12,309	13,760	1,451	11.8
Gross budgetary revenues	**178,017**	**192,350**	**14,333**	**8.1**

Budgetary Expenditures

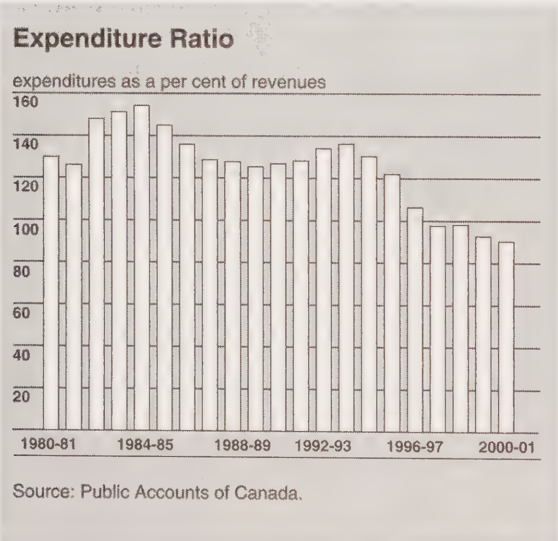
Table 3 on page 16 presents budgetary expenditures on both a gross and net basis. The differences are identical to those between gross and net budgetary revenues.

Net budgetary expenditures amounted to \$161.4 billion in 2000-01, up \$8.0 billion, or 5.2 per cent, from 1999-2000. The expenditure ratio – net budgetary expenditures as a percentage of net budgetary revenues – stood at 90.4 per cent in 2000-01, down from 92.6 per cent in 1999-2000. In 1993-94 the expenditure ratio stood at 136.2 per cent.

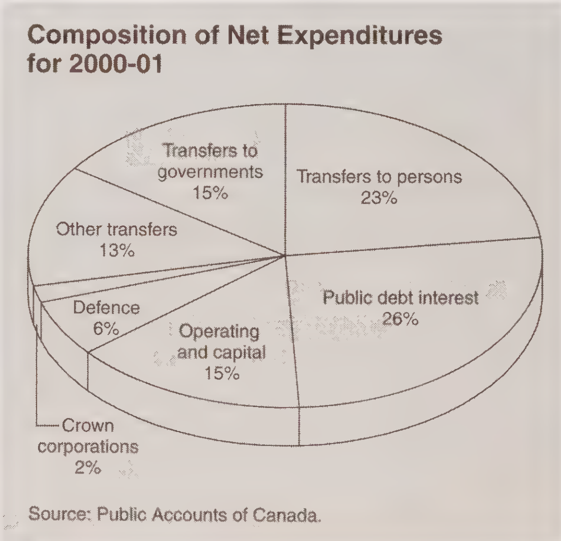
The largest component of budgetary expenditures is public debt charges, representing 26 per cent of total expenditures. Public debt charges increased by \$0.4 billion, or 1.1 per cent, in 2000-01. They are affected by interest rate changes as well as by the stock and composition of interest-bearing debt.

- The average effective interest rate on the Government's interest-bearing debt (unmatured debt and pension liabilities) was 7.6 per cent in 2000-01, compared to 7.4 per cent in 1999-2000. The average effective interest rate on unmatured debt was 6.9 per cent while that on pension and other accounts was 9.7 per cent.
- The stock of total interest-bearing debt declined by \$8.7 billion in 2000-01, from \$597.9 billion to \$589.2 billion, as the stock of market debt declined by \$10.0 billion to \$446.4 billion, while liabilities to pension and other accounts increased by \$1.3 billion to \$142.8 billion. Since 1993-94 the share of market debt has declined by over 4.5 percentage points with a corresponding increase in the liabilities for pension and other accounts. Within market debt, the share of marketable bonds has increased by over 20 percentage points, while that for Treasury bills and Canada Savings Bonds has declined.

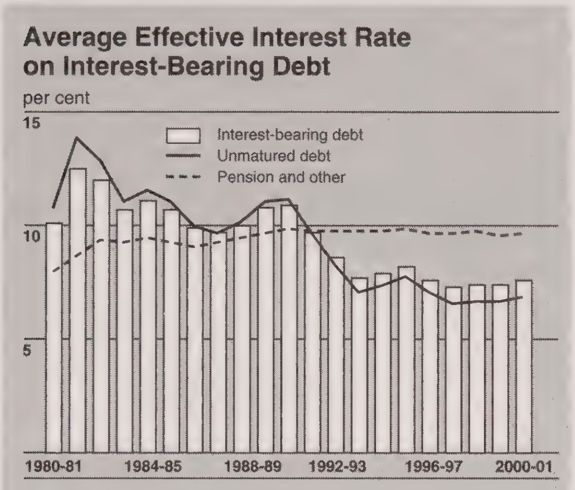
The interest ratio – public debt charges as a percentage of net budgetary revenues – declined from 25.1 per cent in 1999-2000 to 23.6 per cent in 2000-01. This ratio means that, in 2000-01, the Government spent about 24 cents of every revenue dollar on interest on the public debt. This is down from the peak of 36 cents in 1995-96 and is the lowest this ratio has been since 1981-82. This is money that must be paid to meet the Government's obligations on its debt. The lower the ratio, the more flexibility the Government has to address the key priorities of Canadians.



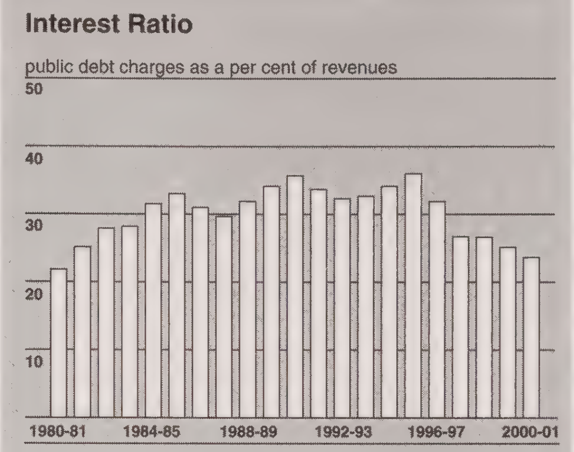
Source: Public Accounts of Canada.



Source: Public Accounts of Canada.



Source: Public Accounts of Canada.



Source: Public Accounts of Canada.

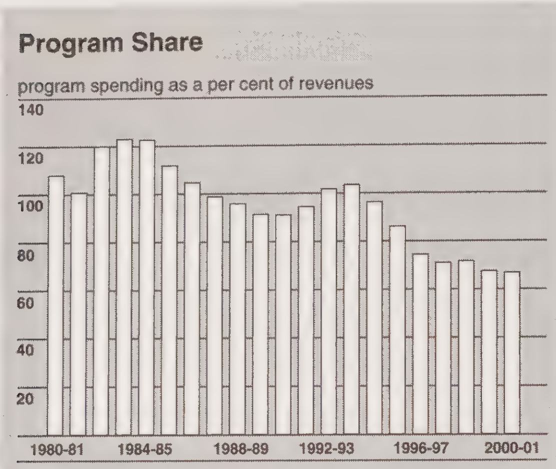
It is worth noting that public debt charges are presented on a gross basis. Yet some of the borrowings undertaken by the Government give rise to a corresponding asset – for example, borrowings undertaken for the Exchange Fund Account. These assets earn interest, which are reported as "return on investments" as part of budgetary revenues. Netting these returns would lower public debt charges by $6.1 billion in 2000-01. On this basis, "net" public debt charges would have declined by $0.4 billion between 1999-2000 and 2000-01.

Net program spending – net budgetary expenditures less public debt charges – amounted to $119.3 billion in 2000-01, an increase of $7.6 billion, or 6.8 per cent, from 1999-2000. The program share – net program spending as a percentage of net budgetary revenues – amounted to 66.8 per cent, down slightly from 1999-2000. In 1993-94 the program share was 103.5 per cent.

Within program spending, major transfer payments to persons increased by $2.4 billion, or 7.1 per cent, primarily reflecting the one-time relief payment for heating expenses and higher elderly benefit payments.

- Elderly benefits consist of Old Age Security payments, Guaranteed Income Supplement payments and spouse's allowance payments. Total benefits were up $0.8 billion in 2000-01, reflecting both higher average benefits, which are indexed to inflation, and an increase in the number of recipients.
- Employment insurance benefits increased $0.1 billion in 2000-01. Regular benefit payments were slightly lower, reflecting the decline in the number of unemployed. In contrast, transfers to the provinces under the Labour Market Development Agreements and special benefits, such as sickness, maternity and parental benefits, were higher. In September 2000 the Government announced changes to employment insurance benefits. These changes received Royal Assent in June 2001, retroactive to October 2000. Liabilities associated with these changes also pushed up overall employment insurance benefits.
- In the October 2000 *Economic Statement and Budget Update*, the Government proposed one-time relief for heating expenses for low- and modest-income Canadians. This benefit, which was paid in January 2001, amounted to $1.5 billion.

Major transfer payments to other levels of government include the Canada Health and Social Transfer (CHST), fiscal arrangements (equalization, transfers to the territories, as well as a number of small transfer programs) and Alternative Payments for Standing Programs. Net cash transfers increased by $1.5 billion in 2000-01, or 6.4 per cent.



Source: Public Accounts of Canada.

- The CHST – a block-funded transfer – supports health care, post-secondary education, social assistance and social services, including early childhood development. It provides support in the form of cash and tax transfers to the provinces and territories. In the 1999 budget the cash floor was increased from \$12.5 billion for 1999-2000 to \$13.5 billion for 2000-01. As part of the September 2000 Agreements on Health Renewal and Early Childhood Development, the federal government has legislated \$21.1 billion of additional cash to be provided under the CHST over the next five years. In the 1999 and 2000 budgets the Government announced special payments of \$3.5 billion and \$2.5 billion, respectively, to be paid to a third-party trust to be drawn by the provinces and territories for health care needs over a period of three to four years. These supplements were charged to the 1998-99 and 1999-2000 fiscal years, respectively.

- As part of the September 2000 Agreements on Health Renewal and Early Childhood Development, the federal government provided \$1 billion to a third-party trust, which the provinces and territories can use to acquire new medical equipment over a period of two years.

- Total entitlements under fiscal arrangements increased by \$2.0 billion, or 18.3 per cent, with equalization accounting for most of the increase. Under the equalization program, the federal government transfers funds to the less prosperous provinces so that they can provide their residents with public services comparable to those in other provinces without having to resort to higher than average taxation. Equalization legislation is renewed every five years. The current legislation, which covers the period 1999-2000 to 2003-04, capped total entitlements in 1999-2000 at \$10 billion, with an annual escalator tied to the growth in nominal GDP. In September 2000 the federal government indicated that the cap for 1999-2000 only would be lifted, resulting in an incremental entitlement for that year of about \$0.8 billion. Legislation authorizing this payment received Royal Assent in June 2001. Under the Government's accounting rules, this amount was charged to 2000-01.

- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allow provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provides provinces with tax points, the value of which are netted against total entitlements and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Direct program spending – total program spending less major transfers to persons and other levels of government – consists of subsidies and other transfer payments, expenditures related to Crown corporations, defence spending, and operating and capital expenditures of non-defence departments and agencies. This spending amounted to \$57.5 billion in 2000-01, up \$3.7 billion, or 6.8 per cent, from 1999-2000.

Within direct program spending:

- Subsidies and other transfer payments increased by $1.7 billion, or 8.6 per cent, primarily reflecting the impact of new initiatives, including:
  - $500 million to the Canada Health Infoway Inc. to accelerate the development and adoption of modern systems of information technology to provide better health care. This investment was part of the September 2000 Agreements on Health Renewal and Early Childhood Development; and
  - $1.25 billion to the Canada Foundation for Innovation to award funds to help post-secondary educational institutions, research hospitals and not-for-profit institutions modernize their research infrastructure and assist in associated operating and maintenance costs. In 1999-2000 the Government provided an additional $900 million. The Government's total transfer to the Canada Foundation for Innovation to date is $3.15 billion.
- Expenditures related to Crown corporations were down slightly. This component includes appropriations to consolidated Crown corporations (those Crown corporations that rely on government funding as their principal source of revenue) and the annual profit and losses for enterprise Crown corporations.
- Operating and capital expenditures include the costs of defence, government administration and delivery of specific services to the public, such as:
  - health care to Aboriginals and veterans;
  - research undertaken by government departments;
  - food inspection;
  - Coast Guard and air and sea rescue;
  - operation of national parks and historic sites;
  - collection of taxes;
  - operation of federal correctional institutions and provision of police services; and
  - administration of programs.
- This spending increased by $2.0 billion, or 6.5 per cent, in 2000-01. Of this amount:
  - Defence spending declined $0.5 billion, primarily attributable to one-time funding provided in 1999-2000 to assist the military in meeting Canada's international commitments.
  - Non-defence departmental operating and capital spending increased $2.5 billion. Most of this increase was attributable to the costs associated with the resumption of collective bargaining after a number of years of wage freezes and incremental funding of about $0.7 billion for operating and capital maintenance. During 1999-2000 the Treasury Board Secretariat conducted a major review of the capacity of a number of government departments to deliver existing programs. This review resulted in increases in funding in a limited number of areas that are regarded as essential to the health and safety of Canadians or critical to sustainability of high-quality public services. Most of this funding was directed to Health Canada, the Royal Canadian Mounted Police, Fisheries and Oceans Canada and the Department of Justice Canada, and to the upgrading and maintenance of federal buildings.

Consistent with the difference between gross and net budgetary revenues, gross budgetary expenditures were $13.8 billion higher than net budgetary expenditures. The differences are described in the section on budgetary revenues.

Table 3
Budgetary Expenditures

	1999-00	2000-01	Net Change	
		($ millions)		(%)
Net major transfers to persons				
Elderly benefits	23,410	24,256	846	3.6
Employment insurance benefits	11,301	11,444	143	1.3
Heating expense relief		1,459	1,459	
Total	34,711	37,159	2,448	7.1
Major transfers to other levels of government				
Canada Health and Social Transfer				
General cash entitlement	12,500	13,500	1,000	8.0
Cash supplement	2,500		-2,500	
Prior-year adjustments	-53		53	
Medical Equipment Fund		1,000	1,000	
Fiscal arrangements	10,721	12,684	1,963	18.3
Alternative Payments for Standing Programs	-2,425	-2,460	-35	1.4
Total	23,243	24,724	1,481	6.4
Net direct program spending				
Subsidies and other transfers				
Agriculture and Agri-food	1,518	1,822	304	20.0
Foreign Affairs and International Trade	2,114	2,358	244	11.5
Health Canada	1,161	1,302	141	12.1
Human Resources Development	2,008	1,995	-13	-0.6
Indian Affairs and Northern Development	4,185	4,448	263	6.3
Industry/regional agencies	2,071	2,079	8	0.4
Veterans Affairs	1,402	1,463	61	4.4
Canada Foundation for Innovation	900	1,250	350	38.9
Canada Health Infoway Inc.		500	500	
Other	4,011	3,827	-184	-4.6
Total	19,370	21,044	1,674	8.6
Crown corporations				
Canada Mortgage and Housing Corporation	1,928	1,906	-23	-1.2
Canadian Broadcasting Corporation	879	902	23	2.6
Other	146	96	-51	-34.6
Total	2,953	2,903	-50	-1.7
Operating and capital expenditures				
Defence	10,201	9,696	-505	-5.0
All other departments	21,285	23,822	2,537	11.9
Total	31,486	33,518	2,032	6.5
Net direct program spending	53,809	57,465	3,656	6.8
Net program spending	**111,763**	**119,348**	**7,585**	**6.8**
Public debt charges	41,647	42,094	447	1.1
Net budgetary expenditures	**153,410**	**161,442**	**8,032**	**5.2**
Adjustments				
Canada Child Tax Benefit	6,000	6,811	811	13.5
Old Age Security benefit repayment	-554	-588	-34	6.2
Quarterly goods and services tax credit	2,847	2,901	54	1.9
Revenues netted against expenditures	2,625	2,874	249	9.5
Revenues of consolidated Crown corporations	1,391	1,762	371	26.7
Net adjustment	12,309	13,760	1,451	11.8
Gross budgetary expenditures	**165,719**	**175,202**	**9,483**	**5.7**

Note: Component totals for 1999-2000 differ from those in the Public Accounts due to reclassification.

The Budgetary Balance, Financial Requirements/Source and Debt

The budgetary balance is the most comprehensive measure of the federal government's fiscal results. It is presented on a modified accrual basis of accounting, largely recording government liabilities when they are incurred, regardless of when the cash payment is made, and recording tax revenues only when cash is received. The budgetary balance covers only those activities over which the Government has legislative control.

In contrast, financial requirements/source measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance in that it includes transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, and changes in other financial assets and liabilities. These activities are included as part of non-budgetary transactions. The conversion from modified accrual to cash accounting is also reflected in non-budgetary transactions.

Non-budgetary transactions in 2000-01 resulted in a net source of funds amounting to $1.8 billion, compared to a net source of $2.3 billion in 1999-2000. Among the major components:

- Loans, investments and advances recorded a net requirement of $1.7 billion, primarily due to the federal government reassuming administration of and borrowings for the Canada Student Loans program from the major banks.
- Pensions and other accounts recorded a net source of funds of $1.3 billion, compared to $7.0 billion in 1999-2000. The lower source primarily reflects the reforms of the federal government employees' pension plans, effective April 1, 2001. Employer and employee contributions to the plans are now invested in financial markets, rather than being included as part of non-budgetary transactions. This reduces the non-budgetary source of funds by about $3 billion per year. In addition, a number of Crown corporations, which were members of the public sector pension plans, have set up their own pension plans, thereby resulting in the transfer of the applicable assets to these new plans.
- Other transactions recorded a net source of $2.2 billion, compared to a net requirement of $4.4 billion in 1999-2000.

With a budgetary surplus of $17.1 billion and a net source of funds from non-budgetary transactions of $1.8 billion, there was a financial source, excluding foreign exchange transactions, of $19.0 billion in 2000-01, up from the financial source of $14.6 billion in 1999-2000. This marks the fifth consecutive year in which a financial source has been recorded.

Financial requirements/source includes foreign exchange transactions. Foreign exchange transactions represent all transactions in international reserves held in the Exchange Fund Account. The purpose of the Exchange Fund Account is to promote order and stability in the foreign exchange market. The buying of Canadian dollars represents a source of funds from exchange fund transactions, while the selling of Canadian dollars represents a requirement. Changes in foreign currency liabilities, which are undertaken to change the level of Canada's foreign exchange reserves, also impact on foreign exchange transactions. Taking all of these factors into account, there was a requirement of $8.8 billion in 2000-01, compared to a requirement of $6.8 billion in 1999-2000.

As a result, there was a net financial source – the budgetary surplus plus non-budgetary and foreign exchange transactions – of $10.2 billion in 2000-01, compared to a net financial source of $7.7 billion in 1999-2000.

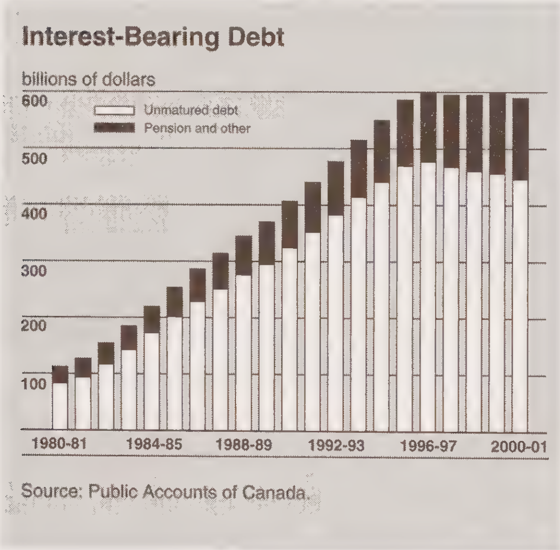
With this net financial source, the Government retired $10.0 billion of its market debt and increased its cash balances by $0.2 billion. Cash balances at March 31, 2001, stood at $13.2 billion.

Total liabilities consist of interest-bearing debt and other liabilities. Interest-bearing debt includes market debt and liabilities for pension and other accounts. At March 31, 2001, interest-bearing debt amounted to $589.2 billion, down $8.7 billion from the level a year earlier. Other liabilities, which include accounts payable and accrued liabilities, amounted to $43.6 billion, up $2.9 billion from 1999-2000. As a result, total liabilities, or gross debt, stood at $632.9 billion.

Financial assets consist of cash and accounts receivable, foreign exchange accounts and loans, investments and advances. Capital assets, inventories and net receivables for tax revenues are not currently included, but will be when the Government moves to full accrual accounting at the end of 2001-02. Capital assets and inventories are fully charged to expenditures at the time of acquisition or construction while tax revenues are reported on a cash basis. Financial assets totalled $85.5 billion at March 31, 2001, up $11.3 billion from March 31, 2000, primarily attributable to increased assets in the foreign exchange accounts, as the government continued to increase foreign exchange reserves to be more in line with other comparable countries. The assets in the foreign exchange reserve earn interest, which is reported as part of budgetary revenues. In 2000-01 gross revenue was $2.3 billion, up $0.4 billion from 1999-2000.

As a result, the accumulated deficit, or net public debt, stood at $547.4 billion at March 31, 2001, down $17.1 billion from March 31, 2000, and $35.8 billion below the peak of $583.2 billion at March 31, 1997.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $97.3 billion at the end of March 2001. This represents 20.8 per cent of the Government's total market debt – the lowest ratio since 1987-88.



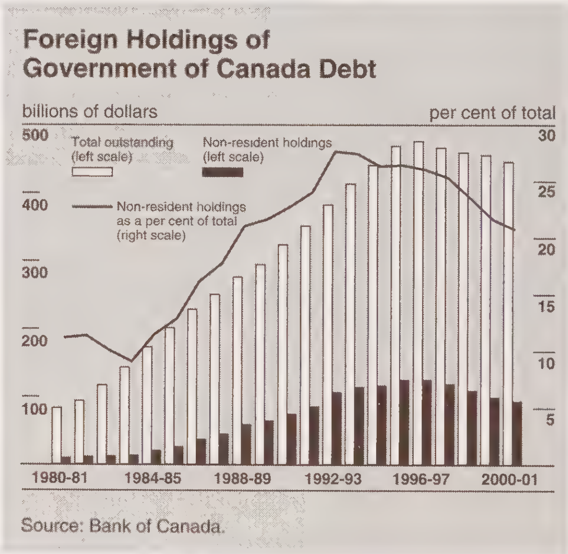


Table 4
Budgetary Balance and Financial Requirements/Source

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
				($ billions)				
Budgetary balance	-42.0	-37.5	-28.6	-8.9	3.5	2.9	12.3	17.1
Non-budgetary transactions								
Loans, investments and advances	0.6	0.3	2.7	0.3	2.0	0.5	-0.3	-1.7
Pensions and other accounts								
Public sector pensions (net)	6.2	6.9	6.8	6.3	3.3	5.0	5.9	0.8
Canada Pension Plan	-0.1	0.7	0.2	0.1	0.5	1.2	0.8	0.2
Other	0.2	1.0	0.6	0.5	0.1	0.9	0.2	0.3
Total	6.2	8.7	7.6	6.9	3.8	7.0	7.0	1.3
Other transactions	5.4	2.6	1.1	3.0	3.4	1.1	-4.4	2.2
Total	12.2	11.6	11.4	10.2	9.3	8.6	2.3	1.8
Financial requirements/source (excluding foreign exchange transactions)	-29.9	-25.8	-17.2	1.3	12.7	11.5	14.6	19.0
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2	-5.7	-6.8	-8.8
Financial balance	-32.0	-27.3	-21.9	-6.5	10.6	5.8	7.7	10.2
Change in borrowings	31.2	27.0	28.5	7.3	-9.6	-6.9	-4.0	-10.0
Change in cash balances	-0.7	-0.2	6.7	0.8	1.0	-1.1	3.7	0.2
Cash in bank (March 31)	2.1	1.9	8.6	9.4	10.4	9.3	13.0	13.2

Table 5
Outstanding Debt at Year-End

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
				($ billions)				
Interest-bearing debt								
Unmatured debt	414.0	441.0	469.5	476.9	467.3	460.4	456.4	446.4
Pension and other accounts	100.5	109.2	116.9	123.7	127.5	134.6	141.5	142.8
Total	514.5	550.2	586.4	600.6	594.8	595.0	597.9	589.2
Other liabilities	31.9	34.6	38.3	40.1	43.7	45.3	40.7	43.6
Total liabilities (gross debt)	546.4	584.8	624.7	640.7	638.5	640.3	638.7	632.9
Financial assets	38.2	39.1	50.4	57.5	58.8	63.5	74.2	85.5
Accumulated deficit (net public debt)	508.2	545.7	574.3	583.2	579.7	576.8	564.5	547.4

Comparison of Actual Budgetary Outcomes to October 2000 *Economic Statement and Budget Update* Estimates

This section compares the actual outcome for the major components of the budgetary balance for 2000-01 with the estimates presented in the October 2000 *Economic Statement and Budget Update*.

Under the Debt Repayment Plan, the fiscal target for each year is based on:

- Using the average of private sector economic forecasts for budget-planning purposes.
- Including an annual Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. It is not a source of funding for new policy initiatives. If not needed, it is used to pay down the public debt. For 2000-01 the Contingency Reserve was set at $3.0 billion.
- Adding an extra degree of economic prudence to provide further assurance against falling back into deficit. In the 2000 budget this economic prudence was set at $1 billion for 2000-01.

In the October 2000 *Economic Statement and Budget Update,* the Government added a new element to its Debt Repayment Plan. Each fall it will announce whether a greater amount should be dedicated to that year's debt paydown. The Government committed to a budgetary surplus of at least $10 billion for 2000-01.

Economic growth for 2000 was significantly stronger than expected at the time of the 2000 budget. Nominal income growth, based on the average of private sector forecasts, was projected at 5.7 per cent for 2000. For the October 2000 *Economic Statement and Budget Update*, this was revised up to 8.0 per cent. Preliminary estimates from Statistics Canada, which were released in late May 2000, suggest that nominal income growth in 2000 averaged 8.3 per cent.

In the October 2000 *Economic Statement and Budget Update*, the fiscal surplus for 2000-01 was estimated at $11.9 billion, of which at least $10 billion was earmarked for debt paydown. The final outcome was $5.2 billion higher, all of which was used for debt paydown.

Budgetary revenues were $4.9 billion higher. Non-tax revenues were $1.7 billion higher, primarily reflecting higher revenues on foreign exchange account transactions. Excise taxes and duties were $1.7 billion higher than expected, primarily reflecting much stronger than anticipated customs import duties. Personal income tax revenues were $0.9 billion higher while other income tax was up $0.8 billion.

Program spending was $0.4 billion lower than estimated in the October 2000 *Economic Statement and Budget Update*, despite the announcement of $2.1 billion of new initiatives, including incremental funding for the Canada Foundation for Innovation, agriculture assistance and defence. The impact of these initiatives was more than offset by lower direct program spending, reflecting higher than expected net gains from enterprise Crown corporations, unamortized pension estimation adjustments associated with several Crown corporations implementing their own pension plans, and higher lapses of appropriations associated with the timing of the federal election. Public debt charges were $0.1 billion lower than estimated.

Table 6

Comparison of Actual Budgetary Outcomes to October 2000 *Economic Statement and Budget Update* Estimates

	Actual	Estimate	Change
		($ billions)	
Budgetary revenues			
Personal income tax	82.3	81.4	0.9
Corporate income tax	28.2	28.5	-0.3
Other income tax	4.3	3.5	0.8
Employment insurance premium revenues	18.7	18.7	0.0
Goods and services tax	25.0	24.2	0.8
Customs import duties	2.8	2.1	0.7
Other excise taxes/duties	8.3	8.1	0.2
Non-tax revenue	8.9	7.2	1.7
Total	178.6	173.7	4.9
Program spending			
Major transfers to persons			
Elderly benefits	24.3	24.3	0.0
Employment insurance benefits	11.4	11.6	-0.2
Heating expense relief	1.5	1.3	0.1
Major transfers to other levels of government			
Canada Health and Social Transfer	14.5	14.5	0.0
Fiscal arrangements	12.7	12.1	0.6
Alternative Payments for Standing Programs	-2.5	-2.4	-0.1
Direct program spending			
Subsidies and other transfers	21.0	20.6	0.4
Crown corporation expenditures	2.9	4.1	-1.2
Defence	9.7	9.4	0.3
All other program spending	23.8	24.3	-0.5
Total	119.3	119.7	-0.4
Public debt charges	42.1	42.2	-0.1
Budgetary balance	**17.1**	**11.9**	**5.2**

REPORT OF THE AUDITOR GENERAL ON THE CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

To the Minister of Finance:

The accompanying condensed statements of revenues, expenditures and accumulated deficit, assets and liabilities and changes in financial position are derived from the complete financial statements of the Government of Canada as at March 31, 2001, and for the year then ended on which I expressed an opinion without reservation in my Report to the House of Commons dated July 23, 2001.

My Report drew two matters to Parliament's attention: a concern my Office has raised before about the Employment Insurance Account, and the recording of transfers to foundations. For more complete information, readers should refer to my Report, which will be included in Volume I of the 2001 *Public Accounts of Canada*, expected to be tabled in the House of Commons later this year.

The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility, in accordance with the applicable Assurance Guideline of The Canadian Institute of Chartered Accountants, is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria described in the Guideline referred to above.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and changes in financial position, reference should be made to the related complete financial statements, which will also be included in Volume I of the 2001 *Public Accounts of Canada*.

Sheila Fraser, FCA
Auditor General of Canada

Sheila Fraser

Ottawa, Canada
July 23, 2001

Condensed Financial Statements of the Government of Canada

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs and resources for which the Government is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the Government.

These financial statements are extracted and condensed from the audited financial statements included in Section 1 of Volume I of the 2001 *Public Accounts of Canada*, which are expected to be tabled in Parliament later this year. As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 7

Government of Canada
Condensed Statement of Revenues, Expenditures and Accumulated Deficit for the Year Ended March 31, 2001

	2001	2000
	($ millions)	
Revenues		
Tax revenues		
Income tax	121,052	111,493
Excise taxes and duties	39,017	35,733
Employment insurance premiums	18,731	18,512
	178,800	165,738
Non-tax revenues	13,550	12,279
Total gross revenues	***192,350***	***178,017***
Amounts deducted to arrive at net revenues	13,760	12,309
Total net revenues	***178,590***	***165,708***
Expenditures		
Transfer payments		
Old Age Security and related payments	23,667	22,856
Other levels of government	23,724	23,243
Employment insurance benefits	11,444	11,301
Other transfer payments	33,216	27,382
	92,051	84,782
Crown corporation expenditures	4,665	4,344
Other program expenditures	36,392	34,946
Total gross program expenditures	***133,108***	***124,072***
Amounts deducted to arrive at net program expenditures	13,760	12,309
Total net program expenditures	***119,348***	***111,763***
Interest on debt	42,094	41,647
Total net expenditures	***161,442***	***153,410***
Surplus for the year	**17,148**	**12,298**
Accumulated deficit at beginning of year	564,526	576,824
Accumulated deficit at end of year	**547,378**	**564,526**

Table 8

Government of Canada
Condensed Statement of Assets and Liabilities
as at March 31, 2001

	2001	2000
	($ millions)	
Liabilities		
Payables, accruals and allowances		
Accounts payable and accruals	34,135	28,904
Allowances for guarantees and employee benefits	9,509	11,844
Total	43,644	40,748
Interest-bearing debt		
Unmatured debt		
Marketable bonds	294,973	293,927
Treasury bills	88,700	99,850
Canada savings and Canada premium bonds	26,099	26,489
Non-marketable bonds and notes	3,473	3,552
Total payable in Canadian currency	413,245	423,818
Payable in foreign currencies	33,158	32,588
Total	446,403	456,406
Pension and other accounts		
Public sector pensions	129,185	128,346
Due to Canada Pension Plan	6,391	6,217
Other	7,253	6,963
Total	142,829	141,526
Total interest-bearing debt	*589,232*	597,932
Total liabilities	***632,876***	***638,680***
Assets		
Cash and accounts receivable		
Cash	15,594	14,511
Accounts receivable	3,592	3,805
Total	19,186	18,316
Foreign exchange accounts	50,270	41,494
Loans, investments and advances		
Enterprise Crown corporations and other government business enterprises	10,085	10,562
National governments and international organizations	7,541	7,316
Other	6,901	5,619
Total	24,527	23,497
Less allowance for valuation	8,485	9,153
Total	16,042	14,344
Total assets	***85,498***	***74,154***
Accumulated deficit	**547,378**	**564,526**

Table 9

Government of Canada
Condensed Statement of Changes in Financial Position
for the Year Ended March 31, 2001

	2001	2000
	($ millions)	
Cash provided by operating activities		
Surplus for the year	17,148	12,298
Add expenditures not requiring cash	5,273	8,324
	22,421	20,622
Net payments from pension and other accounts	(7,111)	(4,010)
Net change in receivables, payables and accruals	4,960	(3,337)
	20,270	13,275
Cash (used for) provided by investing activities		
Net (increase) decrease in loans, investments and advances	(408)	1,390
Cash used for foreign exchange activities		
Net increase (decrease) in foreign currency borrowings	570	(3,412)
Net increase in foreign exchange accounts	(8,776)	(6,826)
	(8,206)	(10,238)
Net cash generated before financing activities	***11,656***	***4,427***
Cash used for financing activities		
Net decrease in Canadian currency borrowings	10,573	609
Net increase in cash	**1,083**	**3,818**
Cash at beginning of year	14,511	10,693
Cash at end of year	***15,594***	***14,511***

Notes to the Condensed Financial Statements

Significant Accounting Policies

The Government of Canada reporting entity includes all departments, agencies, corporations and funds which are owned or controlled by the Government and which are accountable to Parliament. The financial activities of all these entities are consolidated in these statements, except for enterprise Crown corporations and other government business enterprises which are not dependent on the Government for financing their activities. These corporations are reported as investments at their original cost adjusted by an allowance for valuation to reflect their annual profits or losses. The Canada Pension Plan is excluded from the reporting entity as it is under the joint control of the Government and participating provinces.

The Government basically accounts for transactions on an accrual basis. Two notable exceptions are tax revenues and related refunds, which are generally accounted for on a cash basis; and capital assets, which are fully charged to expenditures at the time of acquisition or construction.

As a consequence, the only assets recorded on the Condensed Statement of Assets and Liabilities are financial assets, as they can provide resources to discharge liabilities or finance future operations. Assets are recorded at the lower of cost or net realizable value. Liabilities are recorded on an accrual basis with public sector pension and severance liabilities being determined on an actuarial basis. Valuation allowances are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the Government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable.

Comparative figures for 2000 have been reclassified to conform to the current year's presentation.

Reporting of Revenues and Expenditures on a Gross Basis

Detailed amounts on the Condensed Statement of Revenues, Expenditures and Accumulated Deficit are presented on a gross basis only. Gross revenues include revenues of consolidated Crown corporations, and revenues of government departments, agencies and funds which, on the net basis, are deducted from expenditures for budget and parliamentary authority purposes. Gross expenditures include expenditures determined through the tax system, such as child tax benefits and quarterly GST credits, that are deducted from revenues on the net basis.

Contractual Commitments

Contractual commitments that will materially affect the level of future expenditures include transfer payment agreements, benefit plans for veterans and others, capital asset acquisitions and other purchases, operating and capital leases, and funding of international organizations. At March 31, 2001, contractual commitments amounted to approximately $37 billion ($33 billion in 2000).

Contingent Liabilities

Contingent or potential liabilities that may become actual liabilities in future years include: guarantees by the Government; callable share capital in international organizations; claims and pending and threatened litigation; and environmental contingencies. Contingent liabilities related to guarantees by the Government and to international organizations amount to $72 billion ($67 billion in 2000).

The total amount claimed against the Government for other claims and pending and threatened litigation but not assessed is not determinable. However, there are over $200 billion for Aboriginal and comprehensive land claims. The Government is confident that the ultimate settlement for these contingent liabilities will be for amounts significantly lower than those being disclosed.

Insurance in force relating to self-sustaining insurance programs operated for the Government by three enterprise Crown corporations amounted to approximately $586 billion ($555 billion in 2000). The Government expects that it will not incur any costs to cover the claims for these programs.

Changes in Accounting Policies in 2002

The Government intends to change its basis of accounting from the current modified accrual basis to the full accrual basis for the preparation of its financial statements. The main changes will include the recording of capital assets as non-financial assets on the Statement of Assets and Liabilities and the recording of tax revenues on the accrual basis.

These changes will be done without restatement of the financial statements of 2001, but will require the restatement of the opening balance of the accumulated deficit of the Government as of April 1, 2001.

Other Sources of Information

The Public Accounts of Canada

The *Public Accounts of Canada*, as required under section 64(1) of the Financial Administration Act, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in two volumes:

- Volume I contains the Government's audited financial statements and supporting schedules and information; and
- Volume II contains details of financial operations by ministry (Part I) and additional information and analyses (Part II).

The Budget

The budget, usually introduced in February, presents the Government's overall fiscal plan, incorporating revenue projections and spending plans, which combine to determine the resulting budgetary balance. The budget also introduces proposals for changes in taxation.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the Government together with the reasons underlying major variances.

Debt Management Strategy

This report is tabled annually in Parliament. It provides information on the federal government's debt management strategy for the coming fiscal year.

The Debt Management Report

This annual document provides an accounting of the key elements of federal debt strategy and describes various strategic and operational aspects of the Government's debt program and cash management activities over the past fiscal year.

The Estimates

Each year the Government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board and consists of three parts:

Part I – The Government Expenditure Plan provides an overview of federal spending and summarizes the relationship of the key elements of the Main Estimates to the Expenditure Plan set out in the budget.

Part II – The Main Estimates directly support the Appropriations Act.

Part III – Departmental Expenditure Plans, which consist of two components – Reports on Plans and Priorities and Departmental Performance Reports.

Government
Publications

Annual Financial Report

of the Government of Canada

Fiscal Year 2001–2002

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ANNUAL FINANCIAL REPORT

of the Government of Canada

Fiscal Year 2001–2002

A budgetary surplus of $8.9 billion was recorded in 2001-02. This marks the fifth consecutive year in which the federal government has recorded a surplus – the last time this occurred was in the period up to 1951-52. As a result of the budgetary surpluses recorded since 1997-98, the net debt has been reduced by $46.7 billion to $536.5 billion from its peak of $583.2 billion in 1996-97.

The federal government achieved a surplus in an environment in which most other major economies recorded deficits. This is attributable to stronger-than-expected economic growth in the latter half of the fiscal year and prudence in budget planning, ensuring that monies are not committed without the assurance that we will not go back into deficit.

Because of this prudence, even in the uncertain economic environment of 2001, the Government was able to act to address a number of key priorities. It legislated and implemented the tax cuts announced in the February 2000 budget and October 2000 *Economic Statement and Budget Update*, which provided timely stimulus to the economy. In addition, in the aftermath of the September 11th terrorist attacks, it acted quickly to enhance the security of Canadians and to provide a boost to confidence in the economy.

Department of Finance Canada   Ministère des Finances Canada

Net debt as a percentage of the economy was just over 49 per cent in 2001-02, a reduction of almost 22 percentage points from its peak of about 71 per cent in 1995-96. On an international basis Canada has made more progress in reducing its debt burden than any other Group of Seven (G-7) country. According to the Organisation for Economic Co-operation and Development, Canada's net debt burden is now below the G-7 average – well below those in Italy and Japan and in line with those in Germany and France. Only the United Kingdom and the United States have lower debt levels.

This large reduction in public debt is important for a variety of reasons. A lower debt burden means that a smaller portion of the revenue the Government collects from taxpayers must go towards debt-servicing payments, thereby leaving more resources for reducing taxes and funding valued programs and services. A lower debt burden also lessens the exposure of Canada's fiscal situation to economic shocks, especially an increase in interest rates or prolonged slowdowns in economic activity. And a lower debt burden reduces the amount that younger Canadians will have to pay for servicing debt incurred by the generations that preceded them.

The financial data in this report are based on the audited results, which will appear in more detail in the 2002 *Public Accounts of Canada*, scheduled for tabling in the House of Commons this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 2001 to March 31, 2002) and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* publication has been updated to incorporate the results for 2001-02 and historical revisions to the *National Economic and Financial Accounts* published by Statistics Canada. These tables are an integral part of this report.

The Honourable John Manley, P.C., M.P.
Deputy Prime Minister and Minister of Finance

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Note to Readers

The Canada Customs and Revenue Agency (CCRA) collects personal income taxes on behalf of the Government and all provincial and territorial governments except Quebec. On January 29, 2002, the CCRA announced it had identified a problem in tax accounting that resulted in overpayments to provinces under the tax collection agreements. On September 4, 2002, the Minister of Finance announced that the Government of Canada would recover $1.4 billion of the amounts overpaid for the years 1997 to 1999 and use the money to pay down the debt. The net present value of these amounts has been recast to the fiscal years to which they apply. In addition, once the problem was discovered, the federal government took immediate action to prevent further overpayments related to 2000 and subsequent taxation years. This has resulted in a transfer of $1 billion from the tax collection agreements with respect to taxation year 2000 to budgetary revenues in 2000-01. As a result, the budgetary surplus has been revised upward beginning in 1997-98 as shown in the table below.

Revisions to the Budgetary Surplus

	Originally published	Revised
	($ billions)	
1997-98	3.5	3.8
1998-99	2.9	3.1
1999-00	12.3	12.7
2000-01	17.1	18.1

REPORT HIGHLIGHTS

- A budgetary surplus of $8.9 billion was achieved in 2001-02. This marks the fifth consecutive year the federal budget has been in surplus.
- Net debt has been reduced by $46.7 billion over the last five years. As a result, Canada's net debt at the end of 2001-02 was $536.5 billion.
- The net debt-to-GDP (gross domestic product) ratio is now 49.1 per cent, down sharply from its peak of 70.9 per cent in 1995-96. It is now at its lowest level since 1984-85.
- Market debt – the debt issued on credit markets – as a percentage of GDP has declined to 40.5 per cent from the peak of 57.9 per cent in 1995-96. Foreign holdings declined to 17 per cent of market debt – its lowest ratio since 1986-87.
- The revenue-to-GDP ratio fell to 15.9 per cent in 2001-02, down sharply from 16.9 per cent in 2000-01. This decline reflects, in part, the impact of the tax reductions announced in the February 2000 budget and October 2000 *Economic Statement and Budget Update*.
- Program spending increased 6.1 per cent in 2001-02, of which over 80 per cent was attributable to increased transfers to the provinces and territories under the historic agreements reached by first ministers in September 2000 and higher employment insurance benefits.
- Public debt charges as a percentage of revenues were 21.8 per cent in 2001-02, down from the peak of 36 per cent in 1995-96. This is the lowest the ratio has been since 1979-80.

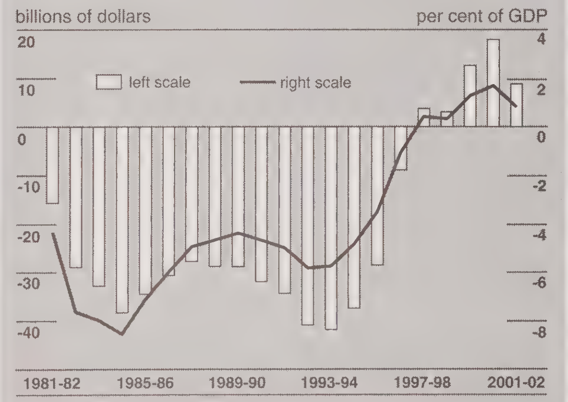
The Budgetary Balance

Economic growth in most major economies slowed sharply in the first half of 2001, reflecting the impact of higher interest rates and energy prices and a sharp decline in global high technology investment. The events of September 11th introduced a further shock to the global economy through disruptions in economic activity and sharp declines in confidence. Like all other countries, Canada was impacted by these developments. Economic growth slowed considerably, from 4.5 per cent in 2000 to only 1.5 per cent in 2001.

However, Canada was much better positioned to cope with the global slowdown than in previous global downturns due to much healthier finances, the timely tax reductions announced in the October 2000 *Economic Statement and Budget Update*, low and stable inflation, declining net foreign debt and historically low interest rates. As a result, the economy did not slow as much as in other countries. Indeed, Canada avoided the U.S. recession and growth rebounded strongly in the first half of 2002.

In the October 2000 *Economic Statement and Budget Update*, May 2001 *Economic Update* and December 2001 budget, the Government committed to a balanced budget or better for 2001-02. The final budgetary surplus for 2001-02 was $8.9 billion. All of this has been applied to reducing Canada's net debt.

Budgetary Balance



Sources: *Public Accounts of Canada* and Statistics Canada.

The budgetary balance went from a deficit of 5.8 per cent of GDP ($42 billion) in 1993-94 to five consecutive surpluses over the 1997-98 to 2001-02 period. The 2001-02 surplus was 0.8 per cent of GDP ($8.9 billion). Nearly three-quarters of the improvement from 1993-94 is attributable to the decline in program spending – from 16.5 per cent of GDP in 1993-94 to 11.6 per cent of GDP in 2001-02, with the remainder attributable to lower public debt charges.

Net Debt

The 2001-02 surplus of $8.9 billion brings the federal government's net debt – the accumulation of annual deficits and surpluses – down to $536.5 billion from its peak of $583.2 billion in 1996-97. As a share of GDP, net debt dropped to 49.1 per cent in 2001-02, down nearly 22 percentage points from the peak of 70.9 per cent in 1995-96. This ratio is generally recognized as the most appropriate indicator of the debt burden as it measures debt relative to the ability of the Government and the country's taxpayers to finance it. This is the sixth consecutive year in which the debt-to-GDP ratio has declined, and it is the lowest the ratio has been since 1984-85.

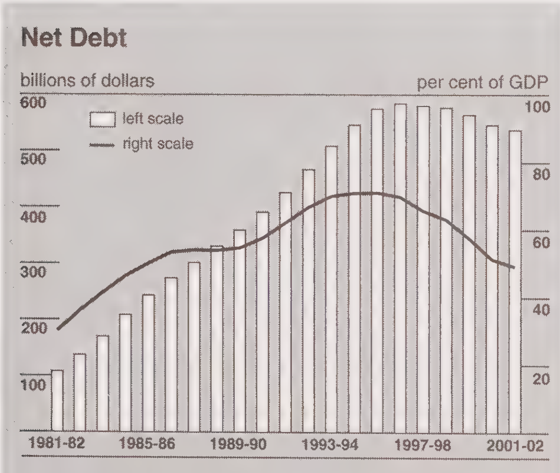
Net debt consists of interest-bearing debt and other liabilities, net of financial assets. Interest-bearing debt, in turn, consists of unmatured, or market, debt and the Government's obligations to internally held accounts – primarily the liabilities for the federal government employees' pension plans. In 2001-02 total interest-bearing debt declined by $5.8 billion: market debt declined by $4.1 billion and obligations to pension accounts declined by $1.7 billion. Other liabilities fell by $3.0 billion, while financial assets increased by $0.1 billion.

Financial Requirements/Source

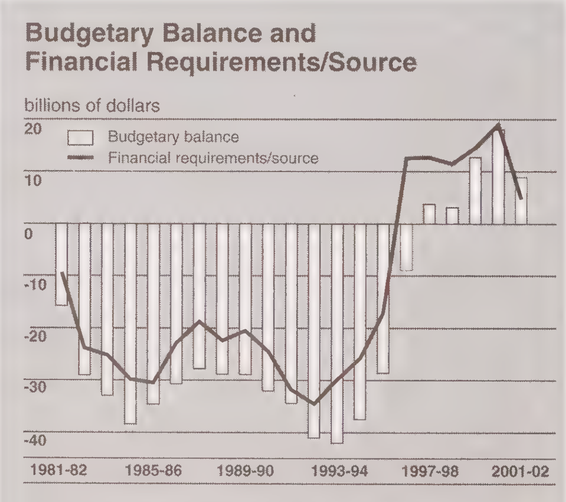
Financial requirements/source measures the difference between cash coming in to the Government and cash going out. Most industrialized countries use a measure comparable to the financial requirements/source as their main measure of the budgetary balance.

There was a financial source (excluding foreign exchange transactions) of $4.7 billion in 2001-02 – the sixth consecutive year Canada has recorded a financial source – the only G-7 country to do so.

In 2001-02 there was a net requirement of $1.8 billion relating to foreign exchange transactions, down from a net requirement of $8.8 billion in 2000-01. Including this amount, the financial source in total was $2.9 billion, down from a source of $10.2 billion in 2000-01.



Sources: *Public Accounts of Canada* and Statistics Canada.



Note: Excludes foreign exchange transactions.
Source: *Public Accounts of Canada.*

Table 1
Financial Highlights

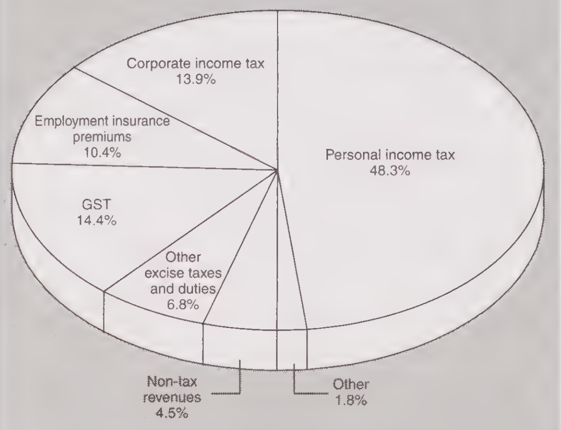
	1997-98	1998-99	1999-00	2000-01	2001-02
			($ billions)		
Budgetary transactions					
Revenues	153.5	155.9	166.1	179.6	173.3
Program spending	-108.8	-111.4	-111.8	-119.3	-126.7
Operating balance	44.8	44.5	54.4	60.2	46.6
Public debt charges	-40.9	-41.4	-41.6	-42.1	-37.7
Budgetary balance	**3.8**	**3.1**	**12.7**	**18.1**	**8.9**
Non-budgetary transactions	8.9	8.4	1.9	0.8	-4.2
Financial requirements/source (excluding foreign exchange transactions)	12.7	11.5	14.6	19.0	4.7
Foreign exchange transactions	-2.2	-5.7	-6.8	-8.8	-1.8
Net financial requirements/source	10.6	5.8	7.7	10.2	2.9
Net change in borrowings	-9.6	-6.9	-4.0	-10.0	-4.1
Net change in cash balances	1.0	-1.1	3.7	0.2	-1.2
Financial position					
Total liabilities	-638.5	-640.3	-638.7	-632.9	-624.1
Total financial assets	59.2	64.0	75.1	87.5	87.6
Accumulated deficit (net debt)	-579.4	-576.3	-563.5	-545.4	-536.5
Financial results (% of GDP)					
Budgetary revenues	17.4	17.0	16.9	16.9	15.9
Program spending	12.3	12.2	11.4	11.2	11.6
Public debt charges	4.6	4.5	4.2	4.0	3.5
Budgetary balance	0.4	0.3	1.3	1.7	0.8
Net debt	65.6	63.0	57.5	51.2	49.1

Note: Results for 1997-98 to 2000-01 have been revised to reflect the misclassification of mutual fund trust capital gain refunds.

Budgetary Revenues

Reflecting much slower growth in 2001 and the tax reductions introduced in the October 2000 *Economic Statement and Budget Update*, budgetary revenues declined by $6.3 billion, or 3.5 per cent, to $173.3 billion in 2001-02 after advancing by 8.1 per cent in the previous year. Declines were spread throughout most major components, with the exception of personal income tax revenues and excise taxes and duties (see Table 2). Even in these latter two components, the rates of increase were substantially less than those recorded in the previous fiscal year. This primarily reflected the impact of the global economic weakness on the various tax bases and the effect of the tax reduction measures announced in the February 2000 budget and October 2000 *Economic Statement and Budget Update*. These measures included the reduction in personal income tax rates; the elimination of the 5-per-cent surtax; increases in thresholds; the restoration of full indexation of the personal income tax system; and increases in the Canada Child Tax Benefit.

Composition of Net Revenues for 2001-02



Note: Numbers do not add to 100% due to rounding.
Source: *Public Accounts of Canada.*

Personal income tax revenues, the largest component of budgetary revenues, were up only $0.5 billion, or 0.6 per cent, in 2001-02 due entirely to prior-year adjustments and the timing of receipts.

- Gross remittances received include federal personal income tax, provincial income tax collected by the Canada Customs and Revenue Agency (CCRA) under the tax collection agreements with participating provinces, as well as employer and employee premiums for employment insurance (EI) and the Canada Pension Plan (CPP). Estimates are made for these various components on a monthly basis, with adjustments made once either preliminary or final data become available from the CCRA. In 2001-02 there were transfers of about $500 million from the EI and CPP accounts to personal income tax relating to overestimations of deductions for previous fiscal years.
- There are also important collection lags between the economic event giving rise to personal income tax liabilities and the receipt of revenues. In April and May 2001 extraordinarily large final tax payments were received with respect to the 2000 taxation year, in large part due to the strong increases in capital gains realizations in 2000. Excluding the impact of the above factors, personal income tax revenues would have recorded a significant decline, reflecting the impact of tax reductions and weakness in economic growth.

Corporate income tax revenues declined $4.2 billion in 2001-02, or 14.9 per cent, following an increase of 21.8 per cent in 2000-01. This decline primarily reflected an estimated 8.9-per-cent decline in corporate profits. In addition, the December 2001 budget announced a six-month deferral of small business corporate income tax instalments for the last quarter of 2001-02 to assist small businesses with the economic slowdown. It is estimated that this measure reduced corporate income tax revenues in 2001-02 by about $600 million.

Table 2
Net Budgetary Revenues

	2000-01	2001-02	Net Change	
		($ millions)		(%)
Net income tax collections				
Personal income tax	83,305	83,790	485	0.6
Corporate income tax	28,212	24,013	-4,199	-14.9
Other	4,312	3,035	-1,277	-29.6
Total	115,829	110,838	-4,991	-4.3
Employment insurance premium revenues	18,731	17,980	-751	-4.0
Net excise taxes and duties				
Goods and services tax	24,990	24,909	-81	-0.3
Customs import duties	2,807	3,018	211	7.5
Other excise taxes/duties				
Energy taxes	4,805	4,758	-47	-1.0
Other	3,514	3,953	439	12.5
Total	8,319	8,711	392	4.7
Total	36,116	36,638	522	1.4
Net tax revenues	170,676	165,456	-5,220	-3.1
Net non-tax revenues				
Return on investments	6,144	5,892	-252	-4.1
Other non-tax revenues[1]	2,770	1,967	-803	-29.0
Total	8,914	7,859	1,055	-11.8
Net budgetary revenues	**179,590**	**173,315**	**-6,275**	**-3.5**

Note: Personal income tax revenues for 2000-01 have been revised to reflect the misclassification of mutual fund trust capital gain refunds.

[1] "Refunds from previous years' expenditures" was reclassified from "Other non-tax revenues" to program spending. This has the effect of reducing revenues and program spending by $578 million.

Other income tax revenues were down $1.3 billion, or 29.6 per cent, primarily due to a consolidation adjustment relating to refundable taxes withheld from the federal Retirement Compensation Arrangements Account that were previously credited to tax revenues.

EI premium revenues were down $0.8 billion, or 4.0 per cent, as prior-year adjustments and the decline in premium rates more than offset the impact of the growth in the number of people employed and therefore paying premiums. The employee premium rate (per $100 of insurable earnings) was reduced from $2.40 for 2000 to $2.25 for 2001 and $2.20 for 2002 (with a corresponding decline in the employer rate).

Excise taxes and duties increased $0.5 billion, or 1.4 per cent. However, there were significant variations among the various components.

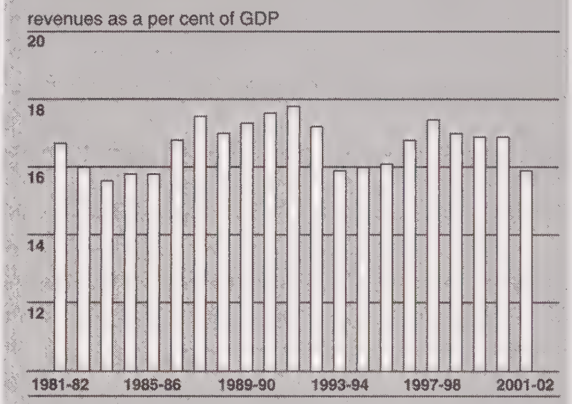
- Goods and services tax (GST) revenues were marginally lower, reflecting declines in GST collected on imported goods and higher rebates.
- Customs import duties increased $0.2 billion, or 7.5 per cent.
- Other excise taxes and duties were up 4.7 per cent, primarily due to the increase in excise tax rates on tobacco products. Energy taxes were slightly lower, reflecting lower taxes collected on aviation fuel.

Non-tax revenues declined $1.1 billion, or 11.8 per cent, in 2001-02, primarily reflecting lower Bank of Canada profits and interest on bank balances due to the decline in interest rates. In addition, "refunds from previous years' expenditures," which in previous years was included as part of "other non-tax revenues," is now netted against program spending. This has the effect of lowering both budgetary revenues and program spending by an equivalent amount, with no impact on the overall budgetary balance.

The revenue ratio – budgetary revenues as a percentage of GDP – represents a comprehensive measure of the overall "tax burden" in that it compares the total of all revenues collected to the size of the economy. The revenue ratio stood at 15.9 per cent in 2001-02, compared to 16.9 per cent in 2000-01. It is now at its lowest level since 1993-94. The decline in the ratio between 2000-01 and 2001-02 reflects the impact of the tax reductions announced in the February 2000 budget and the October 2000 *Economic Statement and Budget Update*, as well as the impact of the global economic slowdown.

It should be noted that some important components of income subject to taxation are excluded from the Statistics Canada measure of GDP, such as capital gains and income from trusteed pension plans. As a result, this ratio overstates the tax burden. In addition, the sharp rise in capital gains and the growth in income from trusteed pension plans due to the aging of the population distort year-to-year changes in the ratio. Therefore, caution should be exercised in interpreting this ratio.

Revenue Ratio



Sources: Department of Finance and Statistics Canada.

The figures in Table 2 are presented on a "net" basis, reflecting the way in which revenues and expenditures are presented to Parliament and in the Government's annual budget. In this presentation, the Canada Child Tax Benefit, the quarterly GST credit and the repayments of Old Age Security benefits are netted against income tax revenues. Certain departmental revenues, such as the revenues of consolidated Crown corporations and revenues levied by departments for specific services (such as the contract costs of policing services in provinces), are netted against spending. This classification has the effect of reducing both revenues and spending but has no impact on the budgetary balance.

Table 3 shows the impact of "grossing up" budgetary revenues for these adjustments. In 2001-02 they amounted to $14.2 billion, of which over half was due to the Canada Child Tax Benefit. As a result, gross budgetary revenues were $187.5 billion in 2001-02, down 3 per cent from 2000-01.

Table 3
Gross Budgetary Revenues

	2000-01	2001-02	Net Change	
		($ millions)		(%)
Net budgetary revenues	**179,590**	**173,315**	**-6,275**	**-3.5**
Adjustments				
Canada Child Tax Benefit	6,811	7,557	746	11.0
Old Age Security benefit repayments	-588	-734	-146	24.8
Quarterly GST credit	2,901	2,964	63	2.2
Revenues netted against expenditures	2,874	2,936	62	2.2
Revenues of consolidated Crown corporations	1,762	1,429	-333	-18.9
Net adjustment	13,760	14,152	392	2.8
Gross budgetary revenues	**193,350**	**187,467**	**-5,883**	**-3.0**

Budgetary Expenditures

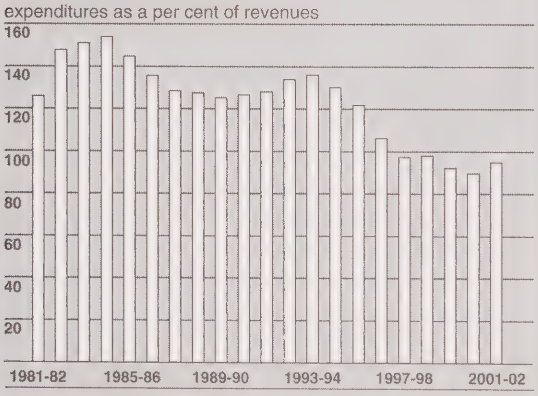
Budgetary expenditures consist of two major components – public debt charges and program spending. Net budgetary expenditures amounted to $164.4 billion in 2001-02, up $3.0 billion, or 1.8 per cent, from 2000-01 (see Table 4). Public debt charges declined $4.4 billion, or 10.4 per cent, while program spending advanced $7.3 billion, or 6.1 per cent. Program spending in 2001-02 was $126.7 billion.

The expenditure ratio – budgetary expenditures as a percentage of net budgetary revenues – stood at 94.9 per cent in 2001-02, up from 89.9 per cent in 2000-01. This increase reflects the impact of both the decline in budgetary revenues and the increase in budgetary expenditures. In 1993-94 the expenditure ratio stood at 136.2 per cent.

Public debt charges declined by $4.4 billion, or 10.4 per cent, to $37.7 billion in 2001-02, primarily attributable to a decline in the stock of interest-bearing debt and lower average effective interest rates on that debt. For the first time since 1985-86 public debt charges are no longer the largest component of budgetary expenditures. At 23.0 per cent of total expenditures, they are slightly less than transfers to persons (elderly and EI benefits).

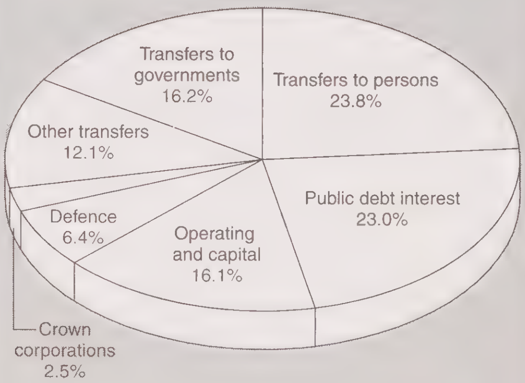
- The average effective interest rate on the Government's interest-bearing debt (unmatured debt and pension liabilities) was 6.9 per cent in 2001-02, compared to 7.6 per cent in 2000-01. The average effective interest rate on unmatured debt was 6.2 per cent while that on pension and other accounts was 9.1 per cent.
- The stock of total interest-bearing debt declined by $5.8 billion in 2001-02, from $589.2 billion to $583.4 billion, as the stock of market debt declined by $4.1 billion to $442.3 billion, while liabilities to pension and other accounts fell by $1.7 billion to $141.2 billion. This is the first year in which liabilities to pension and other accounts have declined, attributable to the impact of the reform of federal employees' pension plans, whereby current contributions are invested in the markets by the Public Sector Pension Investment Board and assets related to a number of Crown corporations are being transferred to them as they establish their plans.

Expenditure Ratio



Source: Department of Finance.

Composition of Net Expenditures for 2001-02



Note: Numbers do not add to 100% due to rounding.
Source: *Public Accounts of Canada.*

Table 4
Net Budgetary Expenditures

	2000-01	2001-02	Net Change	
		($ millions)		(%)
Net major transfers to persons				
Elderly benefits	24,256	25,365	1,109	4.6
Employment insurance benefits	11,444	13,748	2,304	20.1
Relief for Heating Expenses	1,459		-1,459	
Total	37,159	39,113	1,954	5.3
Major transfers to other levels of government				
Canada Health and Social Transfer	13,500	17,300	3,800	28.1
Medical Equipment Fund	1,000		-1,000	
Fiscal arrangements	12,684	11,978	-706	-5.6
Alternative Payments for Standing Programs	-2,460	-2,662	-202	8.2
Total	24,724	26,616	1,892	7.7
Net direct program spending				
Subsidies and other transfers				
Agriculture and Agri-Food	1,822	1,897	75	4.1
Foreign Affairs and International Trade	2,358	2,405	47	2.0
Health Canada	1,302	1,617	315	24.2
Human Resources Development	1,995	1,698	-297	-14.8
Indian Affairs and Northern Development	4,448	4,557	109	2.5
Industry/regional agencies	2,079	2,628	549	26.4
Veterans Affairs	1,463	1,557	94	6.4
Canada Foundation for Innovation	1,250		-1,250	
Canada Health Infoway Inc.	500		-500	
Other	3,827	3,495	-332	-8.7
Total	21,044	19,854	-1,190	-5.7
Crown corporations				
Canada Mortgage and Housing Corporation	1,906	1,910	4	0.2
Canadian Broadcasting Corporation	902	983	81	9.0
Other	95	1,189	1,094	1,151.6
Total	2,903	4,082	1,179	40.6
Operating and capital expenditures				
Defence	9,696	10,571	875	9.0
All other departments	23,822	26,437	2,615	11.0
Total	33,518	37,008	3,490	10.4
Net direct program spending	57,465	60,944	3,479	6.1
Net program spending[1]	**119,348**	**126,673**	**7,325**	**6.1**
Public debt charges	42,094	37,735	-4,359	-10.4
Net budgetary expenditures	**161,442**	**164,408**	**2,966**	**1.8**

[1] "Refunds from previous years' expenditures" was reclassified from "Other non-tax revenues" to program spending. This has the effect of reducing revenues and program spending by $578 million.

The interest ratio – public debt charges as a percentage of net budgetary revenues – declined from 23.4 per cent in 2000-01 to 21.8 per cent in 2001-02. This ratio means that, in 2001-02, the Government spent less than 22 cents of every revenue dollar on interest on the public debt. This is down from the peak of 36 cents in 1995-96 and is the lowest this ratio has been since the late 1970s. This is money that must be paid to meet the Government's obligations on its debt. The lower the ratio, the more flexibility the Government has to address the key priorities of Canadians.

Program spending amounted to $126.7 billion in 2001-02, an increase of $7.3 billion, or 6.1 per cent, from 2000-01. Higher cash transfers to provinces and territories under the Canada Health and Social Transfer (CHST) and increased EI benefits accounted for over 80 per cent of the increase in program spending. All major components were higher, with the exception of subsidies and other transfers.

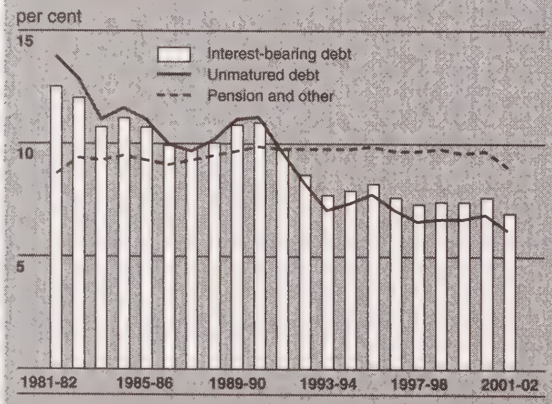
Major transfer payments to persons increased by $2.0 billion, or 5.3 per cent.

- Elderly benefits consist of Old Age Security, Guaranteed Income Supplement and spouse's allowance payments. Total benefits were up $1.1 billion in 2001-02, reflecting both higher average benefits, which are indexed to inflation, and an increase in the number of recipients.
- EI benefits increased $2.3 billion in 2001-02. About half of this increase was attributable to increased regular benefit payments, reflecting the deterioration in the labour market and the accompanying increase in the number of unemployed. Most of the remaining increase was due to higher special benefits, in particular the increase in parental benefits, reflecting the doubling of parental leave from six months to one year.
- Partially offsetting the impact of these developments was the one-time Relief for Heating Expenses for low- and modest-income Canadians of $1.5 billion that was paid in January 2001.

Major transfer payments to other levels of government include the CHST, fiscal arrangements (equalization, transfers to the territories, as well as a number of small transfer programs) and Alternative Payments for Standing Programs. Net cash transfers increased by $1.9 billion in 2001-02, or 7.7 per cent.

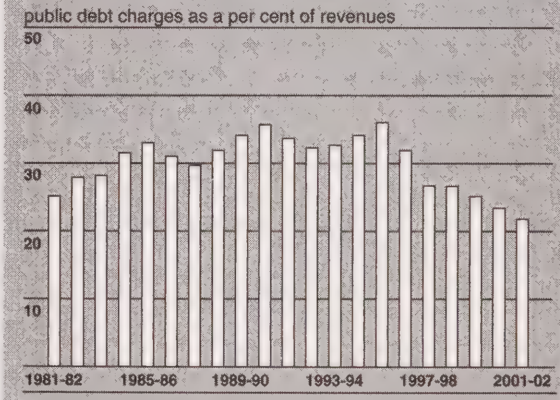
- The CHST – a block-funded transfer – supports health care, post-secondary education, social assistance and social services, including early childhood development. It provides support in the form of cash and tax transfers to the provinces and territories. As part of the September 2000 Agreements

Average Effective Interest Rate on Interest-Bearing Debt



Sources: *Public Accounts of Canada* and Department of Finance.

Interest Ratio



Source: Department of Finance.

on Health Renewal and Early Childhood Development, the federal government legislated $21.1 billion of additional cash to be provided under the CHST over the next five years. As part of this, an incremental $3.8 billion was paid in 2001-02.

- Total entitlements under fiscal arrangements decreased by $0.7 billion, or 5.6 per cent, primarily due to prior-year adjustments affecting equalization entitlements. Under the equalization program, the federal government transfers funds to the less prosperous provinces so that they can provide their residents with public services comparable to those in other provinces without having to resort to higher-than-average taxation. Equalization legislation is renewed every five years. The current legislation, which covers the period 1999-2000 to 2003-04, capped total entitlements in 1999-2000 at $10 billion, with the annual maximum entitlements growing in line with the growth in nominal GDP. The weak growth in nominal GDP in 2001 restrained the overall increase in equalization entitlements for 2001-02. In addition, in September 2000 the federal government indicated that the cap for 1999-2000 only would be lifted, resulting in an incremental entitlement for that year of about $0.8 billion. Under the Government's accounting rules, this amount was charged to 2000-01, thereby accounting for most of the decline between 2000-01 and 2001-02. Finally, transfers to the territories were lower due to recoveries resulting from overpayments in previous years.

- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allow provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provides provinces with tax points, the value of which are netted against total entitlements and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

- Also affecting the year-over-year change was a one-time payment in 2000-01 of $1 billion to a third-party trust for provinces and territories to acquire new medical equipment. This was part of the September 2000 Agreements on Health Renewal and Early Childhood Development.

Direct program spending – total program spending less major transfers to persons and other levels of government – consists of subsidies and other transfer payments, expenditures related to Crown corporations, and operating and capital expenditures of departments and agencies, including National Defence. This spending amounted to $60.9 billion in 2001-02, up $3.5 billion, or 6.1 per cent, from 2000-01. Within direct program spending:

- Subsidies and other transfer payments decreased by $1.2 billion, or 5.7 per cent, primarily reflecting the impact of one-time transfers made in 2000-01. These included:
  - $1.25 billion to the Canada Foundation for Innovation (CFI) to award funds to help post-secondary educational institutions, research hospitals and not-for-profit institutions modernize their research infrastructure and assist in associated operating and maintenance costs. The Government's total transfer to the CFI to date is $3.15 billion.
  - $500 million to the Canada Health Infoway Inc. to accelerate the development and adoption of modern systems of information technology to provide better health care. This investment was part of the September 2000 Agreements on Health Renewal and Early Childhood Development.

- Expenditures related to Crown corporations were up $1.2 billion to $4.1 billion in 2001-02. This component includes appropriations to consolidated Crown corporations (those Crown corporations that rely on government funding as their principal source of revenue) and the annual profit and losses of enterprise Crown corporations. Most of the annual increase was attributable to lower net profits of enterprise Crown corporations.

- Operating and capital expenditures include the costs of defence, government administration and delivery of specific services to the public, such as:
  - health care to Aboriginals and veterans;
  - research undertaken by government departments;
  - food inspection;
  - Coast Guard and air and sea rescue;
  - operation of national parks and historic sites;
  - collection of taxes;
  - operation of federal correctional institutions and provision of police services; and
  - administration of programs.

  This spending increased by $3.5 billion, or 10.4 per cent, in 2001-02. Of this amount:

  - Defence spending increased by $0.9 billion, or 9.0 per cent, primarily due to increased funding related to meeting Canada's international commitments.
  - Non-defence departmental operating and capital spending increased by $2.6 billion. About half of this increase was attributable to new policy initiatives announced during the year, particularly those associated with the implementation of enhanced personal and economic security.

The program share – program spending as a percentage of budgetary revenues – amounted to 73.1 per cent, up from 66.5 per cent 2000-01. In 1993-94 the program share was 103.5 per cent.

The above numbers are presented on a "net" basis, as discussed in the previous section, "Budgetary Revenues." Table 5 shows the impact of the adjustments. Gross expenditures are $14.2 billion higher than net expenditures.

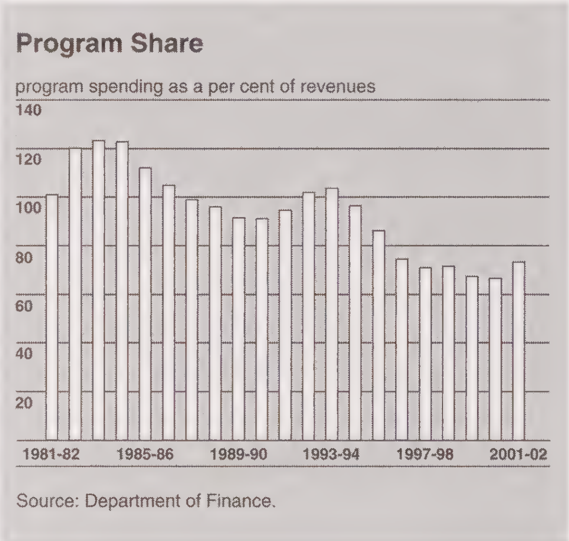


Table 5
Gross Budgetary Expenditures

	2000-01	2001-02	Net Change	
		($ millions)		(%)
Net budgetary expenditures	**161,442**	**164,408**	**2,966**	**1.8**
Adjustments				
Canada Child Tax Benefit	6,811	7,557	746	11.0
Old Age Security benefit repayments	-588	-734	-146	24.8
Quarterly GST credit	2,901	2,964	63	2.2
Revenues netted against expenditures	2,874	2,936	62	2.2
Revenues of consolidated Crown corporations	1,762	1,429	-333	-18.9
Net adjustment	13,760	14,152	392	2.8
Gross budgetary expenditures	**175,202**	**178,560**	**3,358**	**1.9**

The Budgetary Balance, Financial Requirements/Source and Debt

The budgetary balance is the most comprehensive measure of the federal government's fiscal results. It is presented on a modified accrual basis of accounting, largely recording government liabilities when they are incurred, regardless of when the cash payment is made, and recording tax revenues only when cash is received. The budgetary balance covers only those activities over which the Government has legislative control.

In contrast, financial requirements/source measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance in that it includes transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, and changes in other financial assets and liabilities. These activities are included as part of non-budgetary transactions. The conversion from modified accrual to cash accounting is also reflected in non-budgetary transactions. Non-budgetary transactions in 2001-02 resulted in a net requirement of funds amounting to $4.2 billion, compared to a net source of $0.8 billion in 2000-01.

With a budgetary surplus of $8.9 billion and a net requirement of funds from non-budgetary transactions of $4.2 billion, there was a financial source, excluding foreign exchange transactions, of $4.7 billion in 2001-02, down from the financial source of $19.0 billion in 2000-01. This marks the sixth consecutive year in which a financial source has been recorded.

Among the major components of non-budgetary transactions:

- Loans, investments and advances were virtually unchanged, as the impact of borrowings for the Canada Student Loans Program was offset by repayments from Crown corporations and others.
- Pensions and other accounts recorded a net requirement of funds of $1.7 billion, compared to net source of $1.3 billion in 2000-01. The net requirement primarily reflects the reforms of the federal government employees' pension plans, effective April 1, 2000. Employer and employee contributions to the plans are now invested in financial markets, rather than being included as part of non-budgetary transactions. This reduces the non-budgetary source of funds by about $3 billion per year. In addition, a number of Crown corporations, which were members of the public sector pension plans, have set up their own pension plans, resulting in the transfer of the applicable assets to these new plans.
- Other transactions recorded a net requirement of $2.4 billion, compared to a net source of $2.2 billion in 2000-01. Developments in this component primarily reflect the conversion of accrual liabilities to cash. For example, in 2000-01 the federal government committed to providing the CFI with an additional $1.25 billion. This liability affected budgetary expenditures and therefore the budgetary balance in 2000-01, but had no impact on the financial balance, as the payment to the CFI was not made until June 2001. As a result, this liability resulted in a net source of funds in non-budgetary transactions in 2000-01 but a requirement for funds in 2001-02.

Financial requirements/source includes foreign exchange transactions. Foreign exchange transactions represent all transactions in international reserves held in the Exchange Fund Account (EFA). The objectives of the EFA are to provide general foreign currency liquidity for the Government and promote orderly conditions in the foreign exchange market. The EFA contains foreign currency investments, the Government's gold holdings and assets related to Canada's

commitment to the International Monetary Fund (IMF). Increases in the level of reserves through borrowings, contributions to the IMF, and/or selling of Canadian dollars represent a requirement. Conversely, decreases in the level of reserves represent a source of funds. Taking all of these factors into account, there was a net requirement of $1.8 billion in 2001-02, compared to a net requirement of $8.8 billion in 2000-01.

As a result, there was a net financial source – the budgetary surplus plus non-budgetary and foreign exchange transactions – of $2.9 billion in 2001-02, compared to a net financial source of $10.2 billion in 2000-01.

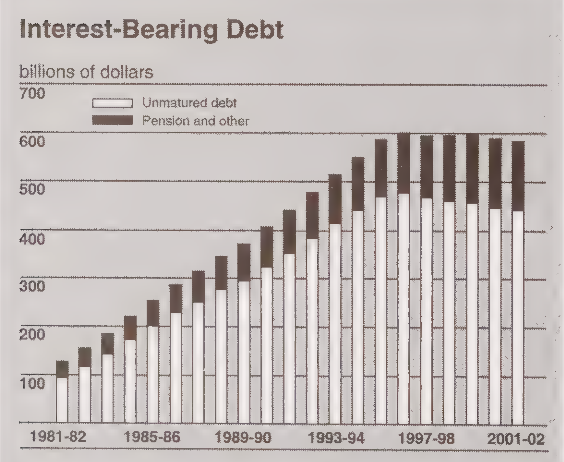
With this net financial source and a drawing down of its cash balances, the Government retired $4.1 billion of its market debt. Cash balances at March 31, 2002, stood at $12.0 billion.

Total liabilities consist of interest-bearing debt and other liabilities. Interest-bearing debt includes unmatured, or market, debt and liabilities for pension and other accounts. At March 31, 2002, interest-bearing debt amounted to $583.4 billion, down $5.8 billion from the level a year earlier. Other liabilities, which include accounts payable and accrued liabilities, amounted to $40.7 billion, down $3.0 billion from 2000-01. As a result, total liabilities, or gross debt, stood at $624.1 billion.

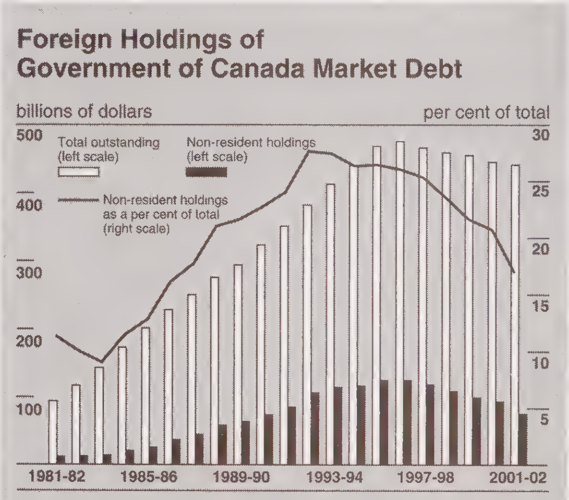
Financial assets consist of cash and accounts receivable, foreign exchange accounts and loans, investments and advances. Capital assets, inventories and net receivables for tax revenues are not currently included, as capital assets and inventories are fully charged to expenditures at the time of acquisition or construction while tax revenues are reported on a cash basis. Financial assets totalled $87.6 billion at March 31, 2002, virtually unchanged from March 31, 2001.

As a result, net debt stood at $536.5 billion at March 31, 2002, down $8.9 billion from March 31, 2001, and $46.7 billion below the peak of $583.2 billion at March 31, 1997.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $75.1 billion at the end of March 2002. This represents 17 per cent of the Government's total market debt – the lowest ratio since 1986-87.



Source: *Public Accounts of Canada.*



Source: Bank of Canada.

Table 6
Budgetary Balance and Financial Requirements/Source

	1997-98	1998-99	1999-00	2000-01	2001-02
			($ billions)		
Budgetary balance	3.8	3.1	12.7	18.1	8.9
Non-budgetary transactions					
Loans, investments and advances	1.6	0.3	-0.6	-2.7	-0.1
Pensions and other accounts					
Public sector pensions (net)	3.3	5.0	5.9	0.8	-2.3
Canada Pension Plan	0.5	1.2	0.8	0.2	0.4
Other	0.1	0.9	0.2	0.3	0.2
Total	3.8	7.0	7.0	1.3	-1.7
Other transactions	3.5	1.0	-4.5	2.2	-2.4
Total	8.9	8.4	1.9	0.8	-4.2
Financial requirements/source (excluding foreign exchange transactions)	12.7	11.5	14.6	19.0	4.7
Foreign exchange transactions	-2.2	-5.7	-6.8	-8.8	-1.8
Net financial balance	10.6	5.8	7.7	10.2	2.9
Net change in borrowings	-9.6	-6.9	-4.0	-10.0	-4.1
Change in cash balances	1.0	-1.1	3.7	0.2	-1.2
Cash in bank (March 31)	10.4	9.3	13.0	13.2	12.0

Table 7
Outstanding Debt at Year-End

	1997-98	1998-99	1999-00	2000-01	2001-02
			($ billions)		
Interest-bearing debt					
Unmatured debt	467.3	460.4	456.4	446.4	442.3
Pension and other accounts	127.5	134.6	141.5	142.8	141.2
Total	594.8	595.0	597.9	589.2	583.4
Other liabilities	43.7	45.3	40.7	43.6	40.7
Total liabilities (gross debt)	638.5	640.3	638.7	632.9	624.1
Financial assets	59.2	64.0	75.1	87.5	87.6
Accumulated deficit (net debt)	579.4	576.3	563.5	545.4	536.5

Comparison of Actual Budgetary Outcomes to Budget Estimates

This section compares the actual outcome for the major components of the budgetary balance for 2001-02 to the original estimates presented in the October 2000 *Economic Statement and Budget Update*, as well as to the updated estimates presented in the December 2001 budget.

The Government targeted a balanced budget for 2001-02 in both the October 2000 *Economic Statement and Budget Update* and December 2001 budget. Under the Debt Repayment Plan, the fiscal target for each year is based on:

- Using the average of private sector economic forecasts for budget-planning purposes.
- Including an annual Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. It is not a source of funding for new policy initiatives. If not needed, it is used to reduce the public debt. For 2001-02 the Contingency Reserve was originally set at $3.0 billion. In the December 2001 budget, it was reduced to $1.5 billion to help cover some of the costs associated with the unforeseen circumstances of the global economic slowdown and the terrorist attacks of September 11th.
- Adding an extra degree of economic prudence to provide further assurance against falling back into deficit. In 2001-02 this economic prudence was originally set at $1 billion. In the December 2001 budget the Government used the economic prudence to manage the exceptional fiscal pressures resulting from the global economic slowdown and terrorist attacks.

Comparison to October 2000 *Economic Statement and Budget Update*

Economic growth for 2001 was significantly weaker than expected at the time of the October 2000 *Economic Statement and Budget Update*. Nominal income growth, based on the average of private sector forecasts, was projected at 5.5 per cent for 2001. However, the effects of the global economic slowdown in 2001 restrained the growth to 2.6 per cent, down considerably from the increase of 8.6 per cent reported for 2000.

In the October 2000 *Economic Statement and Budget Update*, before adjusting for the Contingency Reserve and economic prudence, there was an underlying surplus of $8.3 billion. After adjusting for the Contingency Reserve and economic prudence, there remained an unallocated balance of $4.3 billion, which the Government indicated could be directed to further debt reduction, increasing the prudence, further tax cuts or increased spending in priority areas.

The final outcome for 2001-02 was $8.9 billion, $0.6 billion higher than the underlying balance estimated in the October 2000 *Economic Statement and Budget Update*, as lower-than-expected public debt charges offset the impact of lower budgetary revenues and higher program spending (see Table 8). As a result, the prudence of $4.0 billion set aside in the *Economic Statement and Budget Update* was not required.

Table 8

Comparison of Actual Outcomes to October 2000 *Economic Statement and Budget Update*

	Actual	October 2000 *Economic Statement and Budget Update*	Difference
		($ billions)	
Budgetary revenues			
Personal income tax	83.8	80.5	3.3
Corporate income tax	24.0	28.6	-4.6
Other income tax	3.0	3.6	-0.5
Employment insurance premium revenues	18.0	18.4	-0.4
Excise taxes and duties	36.6	36.2	0.4
Non-tax revenue	7.9	7.2	0.6
Total	173.3	174.5	-1.2
Program spending			
Major transfers to persons			
Elderly benefits	25.4	25.2	0.2
Employment insurance benefits	13.7	12.2	1.5
Major transfers to other levels of government			
Canada Health and Social Transfer	17.3	17.3	0.0
Fiscal arrangements	12.0	12.5	-0.6
Alternative Payments for Standing Programs	-2.7	-2.5	-0.2
Direct program spending	60.9	59.9	1.1
Total	126.7	124.6	2.1
Public debt charges	37.7	41.7	-3.9
Underlying budgetary surplus	8.9	8.3	0.6
Prudence			
Contingency Reserve		3.0	-3.0
Economic prudence		1.0	-1.0
Total		4.0	-4.0
Budgetary outcome	8.9	4.3	4.6
Non-budgetary transactions	-4.2	-3.0	-1.2
Financial requirements/source (excluding foreign exchange transactions)[1]	4.7	-3.0	7.7

[1] In the *Economic Statement and Budget Update* a balanced budget was assumed for 2001-02.

Budgetary revenues were $1.2 billion lower than estimated in the October 2000 *Economic Statement and Budget Update*, primarily due to lower-than-expected corporate income tax revenues, which offset higher-than-expected personal income tax revenues. Personal income tax revenues were $3.3 billion higher, with about two-thirds due to higher payments on filing relating to the strong growth in net capital gains realizations in 2000, and the remainder due to prior-year adjustments. Corporate income taxes were $4.6 billion lower than forecast due to the weakness in global economic activity and its effect on corporate profits. Largely offsetting differences were reported among the other major components.

Program spending was $2.1 billion higher than estimated in the October 2000 *Economic Statement and Budget Update*. This primarily reflected higher EI benefits, due to the deterioration in the labour market in 2001, and increased direct program spending due to the new initiatives announced in the May 2001 *Economic Update* and December 2001 budget. In contrast, entitlements under fiscal arrangements were lower, reflecting the weakness in economic growth.

Public debt charges were $3.9 billion lower than forecast, reflecting the dramatic decline in short-term interest rates during 2001.

Comparison to December 2001 Budget

At the time of the December 2001 budget estimates indicated that the Canadian economy had contracted in the third quarter of 2001, and most forecasters were expecting further weakness in the fourth quarter, with only modest growth in the first half of 2002. Based on these economic planning assumptions and incorporating the impact of the budget initiatives, an underlying surplus of $1.5 billion was estimated. This amount was allocated to the Contingency Reserve.

However, stronger growth was recorded in the final quarter of 2001, and the recovery in the first half of 2002 was much faster and stronger than had been projected. As a result, budgetary revenues were higher than expected (up $2 billion – see Table 9). Most of this increase in budgetary revenues resulted from continued strength in personal income tax revenues (up $3.5 billion), as strong employment gains were recorded in the first quarter of 2002, and prior-year adjustments related to overpayments to the tax collection accounts.

Program spending was $3.9 billion lower than expected, reflecting lower-than-expected liabilities at year-end and a higher-than-assumed lapse in spending authority. The decline in public debt charges (down $1.5 billion) was attributable to lower-than-expected interest accrued on Canada Savings Bonds and pension account liabilities, reflecting the large declines in market interest rates.

Table 9

Comparison of Actual Outcomes to December 2001 Budget

	Actual	December 2001 budget	Difference
		($ billions)	
Budgetary revenues			
Personal income tax	83.8	80.3	3.5
Corporate income tax	24.0	23.6	0.4
Other income tax	3.0	4.0	-1.0
Employment insurance premium revenues	18.0	17.8	0.2
Excise taxes and duties	36.6	37.2	-0.6
Non-tax revenue	7.9	8.4	-0.5
Total	173.3	171.4	2.0
Program spending			
Major transfers to persons			
Elderly benefits	25.4	25.3	0.1
Employment insurance benefits	13.7	14.1	-0.4
Major transfers to other levels of government			
Canada Health and Social Transfer	17.3	17.3	0.0
Fiscal arrangements	12.0	12.2	-0.2
Alternative Payments for Standing Programs	-2.7	-2.4	-0.3
Direct program spending	60.9	64.1	-3.2
Total	126.7	130.6	-3.9
Public debt charges	37.7	39.2	-1.5
Underlying budgetary surplus	8.9	1.5	7.4
Prudence			
Contingency Reserve		1.5	-1.5
Economic prudence		0.0	0.0
Total		1.5	-1.5
Budgetary outcome	8.9	0.0	8.9
Non-budgetary transactions	-4.2	-1.9	-2.3
Financial requirements/source (excluding foreign exchange transactions)	4.7	-1.9	6.6

Report of the Auditor General on the Condensed Financial Statements of the Government of Canada

To the Minister of Finance:

The accompanying condensed statements of revenues, expenditures and accumulated deficit, assets and liabilities and changes in financial position are derived from the complete financial statements of the Government of Canada as at March 31, 2002, and for the year then ended on which I expressed an opinion without reservation in my Report to the House of Commons dated September 16, 2002.

My Report drew two matters I have raised before to Parliament's attention: a concern about the Employment Insurance Account, and the recording of transfers to Foundations. For more complete information, readers should refer to my Report, which will be included in Volume I of the *2002 Public Accounts of Canada*, expected to be tabled in the House of Commons later this year.

The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility, in accordance with the applicable Assurance Guideline of The Canadian Institute of Chartered Accountants, is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria described in the Guideline referred to above.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and changes in financial position, reference should be made to the related complete financial statements, which will also be included in Volume I of the *2002 Public Accounts of Canada*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
September 16, 2002

CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs and resources for which the Government is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the Government.

These financial statements are extracted and condensed from the audited financial statements included in Section 1 of Volume I of the *2002 Public Accounts of Canada*, which are expected to be tabled in Parliament later this year. As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 10

Government of Canada
Condensed Statement of Revenues, Expenditures and Accumulated Deficit for the Year Ended March 31, 2002

	2002	Restated 2001
	($ millions)	
Revenues		
Tax revenues		
Income tax	117,661	122,052
Other taxes and duties	39,602	39,017
Employment insurance premiums	17,980	18,731
	175,243	179,800
Non-tax revenues	12,224	13,550
Total gross revenues	***187,467***	***193,350***
Amounts deducted to arrive at net revenues	14,152	13,760
Total net revenues	***173,315***	***179,590***
Expenditures		
Transfer payments		
Old Age Security and related payments	24,632	23,667
Other levels of government	26,616	23,724
Employment insurance benefits	13,748	11,444
Other transfer payments	30,375	33,216
	95,371	92,051
Crown corporation expenditures	5,511	4,665
Other program expenditures	39,943	36,392
Total gross program expenditures	***140,825***	***133,108***
Amounts deducted to arrive at net program expenditures	14,152	13,760
Total net program expenditures	***126,673***	***119,348***
Interest on debt	37,735	42,094
Total net expenditures	***164,408***	***161,442***
Surplus for the year	**8,907**	**18,148**
Opening accumulated deficit as originally reported	547,378	564,526
Less: Adjustment to tax revenues (note 2)	1,982	982
Opening accumulated deficit as restated	545,396	563,544
Accumulated deficit at end of year	**536,489**	**545,396**

Table 11

Government of Canada
Condensed Statement of Assets and Liabilities
as at March 31, 2002

	2002	Restated 2001
	($ millions)	
Liabilities		
Payables, accruals and allowances		
Accounts payable and accruals	31,434	34,135
Allowances for guarantees and employee benefits	9,245	9,509
Total	40,679	43,644
Interest-bearing debt		
Unmatured debt		
Marketable bonds	293,843	294,973
Treasury bills	94,039	88,700
Canada savings and Canada premium bonds	23,966	26,099
Non-marketable bonds and notes	3,391	3,473
Total payable in Canadian currency	415,239	413,245
Payable in foreign currencies	27,032	33,158
Total	442,271	446,403
Pension and other accounts		
Public sector pensions	126,921	129,185
Due to Canada Pension Plan	6,770	6,391
Other	7,469	7,253
Total	141,160	142,829
Total interest-bearing debt	583,431	589,232
Total liabilities	***624,110***	***632,876***
Assets		
Cash and accounts receivable		
Cash	13,467	15,594
Accounts receivable	3,362	2,966
Total	16,829	18,560
Foreign exchange accounts	52,046	50,270
Loans, investments and advances		
Enterprise Crown corporations and other government business enterprises	9,192	10,085
National governments and international organizations	7,342	7,541
Other	11,283	10,203
Total	27,817	27,829
Less allowance for valuation	9,071	9,179
Total	18,746	18,650
Total assets	***87,621***	***87,480***
Accumulated deficit	***536,489***	***545,396***

Table 12

Government of Canada
Condensed Statement of Changes in Financial Position
for the Year Ended March 31, 2002

	2002	Restated 2001
	($ millions)	
Cash provided by operating activities		
Surplus for the year	8,907	18,148
Expenditures not requiring cash	9,301	5,194
	18,208	23,342
Net payments from pension and other accounts	(10,470)	(7,111)
Net change in receivables, payables and accruals	(4,006)	4,960
	3,732	21,191
Cash provided (used for) investing activities		
Net decrease (increase) in loans, investments and advances	49	(1,329)
Cash used for foreign exchange activities		
Net (decrease) increase in foreign currency borrowings	(6,126)	570
Net increase in foreign exchange accounts	(1,776)	(8,776)
	(7,902)	(8,206)
Net cash (required) generated before financing activities	***(4,121)***	***11,656***
Cash provided by (used for) financing activities		
Net increase (decrease) in Canadian currency borrowings	1,994	(10,573)
Net (decrease) increase in cash	**(2,127)**	**1,083**
Cash at beginning of year	15,594	14,511
Cash at end of year	***13,467***	***15,594***

Notes to the Condensed Financial Statements

1. Significant Accounting Policies

The Government of Canada reporting entity includes all departments, agencies, corporations and funds which are owned or controlled by the Government and which are accountable to Parliament. The financial activities of all these entities are consolidated in these statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the Government for financing their activities. These corporations are reported as investments at their original cost adjusted by an allowance for valuation to reflect their annual profits or losses. The Canada Pension Plan is excluded from the reporting entity as it is under the joint control of the Government and participating provinces.

The Government basically accounts for transactions on an accrual basis. Two notable exceptions are tax revenues and related refunds, which are generally accounted for on a cash basis; and capital assets, which are fully charged to expenditures at the time of acquisition or construction.

As a consequence, the only assets recorded on the Condensed Statement of Assets and Liabilities are financial assets, as they can provide resources to discharge liabilities or finance future operations. Assets are recorded at the lower of cost or net realizable value. Liabilities are recorded on an accrual basis with public sector pension and severance liabilities being determined on an actuarial basis. Valuation allowances are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the Government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable.

Comparative figures for 2001 have been reclassified to conform to the current year's presentation.

2. Overpayments Under Tax Collection Agreements

On September 4, 2002, the Government announced its decision to recover over a 10-year period beginning in fiscal year 2004-2005, approximately $1,421 million in overpayments to provinces related to mutual fund trust capital gain refunds applicable to the 1997 to 1999 tax years.

The misclassification of mutual fund trust capital gain refunds resulted in the understatement of tax revenues for fiscal years prior to 2001-2002. To reflect the increase in tax revenues resulting from the decision to recover $1,421 million in overpayments, $982 million on a present value basis, for fiscal years 1997-1998 to 1999-2000, the opening accumulated deficit as at March 31, 2000 has been decreased by $982 million. In addition, the financial statements for fiscal year 2000-2001 have been restated to reflect a $1,000 million increase in tax revenues due to the correction of the understatement of tax revenues for tax year 2000. The cumulative effect of these adjustments results in a decrease in the opening accumulated deficit as at March 31, 2001, of $1,982 million.

3. Reporting of Revenues and Expenditures on a Gross Basis

Detailed amounts on the Condensed Statement of Revenues, Expenditures and Accumulated Deficit are presented on a gross basis only. Gross revenues include revenues of consolidated Crown corporations, and revenues of government departments, agencies and funds which, on the net basis, are deducted from expenditures for budget and parliamentary authority purposes. Gross expenditures include expenditures determined through the tax system, such as child tax benefits and quarterly GST tax credits, that are deducted from revenues on the net basis.

4. Contractual Commitments

Contractual commitments that will materially affect the level of future expenditures include transfer payment agreements, benefit plans for veterans and others, capital asset acquisitions and other purchases, operating and capital leases, and funding of international organizations. At March 31, 2002, contractual commitments amounted to approximately $40 billion ($37 billion in 2001).

5. Contingent Liabilities

Contingent or potential liabilities that may become actual liabilities in future years include: guarantees by the Government; callable share capital in international organizations; claims and pending and threatened litigation; and environmental contingencies. Contingent liabilities related to guarantees by the Government and to international organizations amount to $77 billion ($72 billion in 2001). The total amount claimed against the Government for other claims and pending and threatened litigation is not determinable; however, there are over $200 billion in claims for Aboriginal and comprehensive land claims. The Government is confident that the ultimate settlement for these contingent liabilities will be for amounts significantly lower than those being disclosed.

Insurance in force relating to self-sustaining insurance programs operated for the Government by three enterprise Crown corporations amounted to approximately $615 billion ($586 billion in 2001). The Government expects that it will not incur any costs to cover the claims for these programs.

6. Changes in Accounting Policies

The Government had intended to change its basis of accounting from the current modified accrual basis to the full accrual basis for the preparation of these financial statements. Given the timing of the 2001 budget and the fact that important components of the information required to implement full accrual accounting had not yet been verified and audited, the Government decided to delay the implementation of full accrual accounting for at least one year.

Other Sources of Information

The Public Accounts of Canada

The *Public Accounts of Canada*, as required under section 64(1) of the Financial Administration Act, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in two volumes:

- Volume I contains the Government's audited financial statements and supporting schedules and information; and
- Volume II contains details of financial operations by ministry (Part I) and additional information and analyses (Part II).

The Budget

The budget, usually introduced in February, presents the Government's overall fiscal plan, incorporating revenue projections and spending plans, which combine to determine the resulting budgetary balance. The budget also introduces proposals for changes in taxation.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the Government together with the reasons underlying major variances.

Debt Management Strategy

This report is tabled annually in Parliament. It provides information on the federal government's debt management strategy for the coming fiscal year.

The Debt Management Report

This annual document provides an accounting of the key elements of federal debt strategy and describes various strategic and operational aspects of the Government's debt program and cash management activities over the past fiscal year.

The Estimates

Each year the Government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board and consists of three parts:

Part I – The Government Expenditure Plan provides an overview of federal spending and summarizes the relationship of the key elements of the Main Estimates to the Expenditure Plan set out in the budget.

Part II – The Main Estimates directly support the Appropriations Act.

Part III – Departmental Expenditure Plans, which consist of two components – Reports on Plans and Priorities and Departmental Performance Reports.

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Annual Financial Report

of the Government of Canada

Fiscal Year 2002–2003

Canada

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Annual Financial Report

of the Government of Canada

Fiscal Year 2002–2003

The federal government posted a budgetary surplus of $7.0 billion in 2002–03, marking the sixth consecutive year in which it has recorded a surplus—the last time this occurred was in the period up to 1951–52. As a result of the budgetary surpluses recorded since 1997–98, the federal debt (accumulated deficit) has been reduced by $52.3 billion to $510.6 billion from its peak of $562.9 billion in 1996–97. At the same time, the Government implemented the largest tax cut in Canadian history and invested in the key priorities of Canadians, such as health care, support for low-income families with children, education, and research and development.

Sound financial management played an important role in helping Canada avoid a recession in 2001–2002, despite the global economic downturn. It enabled fiscal and monetary policy to provide timely support to the Canadian economy through lower taxes and interest rates. And according to the Organisation for Economic Co-operation and Development (OECD), Canada was the only Group of Seven (G-7) country to post a surplus in 2002.

Federal debt as a percentage of the economy was just over 44 per cent in 2002–03, a reduction of almost 25 percentage points from its peak of 68.4 per cent in 1995–96. On an international basis, Canada has made more progress in reducing its debt burden than any other G-7 country.

Department of Finance Canada | Ministère des Finances Canada

According to the OECD, Canada's net debt burden is now below the G-7 average—well below those in Italy and Japan and in line with those in Germany, France and the United States. Only the United Kingdom has a significantly lower debt burden.

This large reduction in federal debt is important for a variety of reasons. A lower debt burden, resulting from a reduction in interest-bearing debt, means that a smaller portion of the revenue the Government collects from taxpayers must go towards debt-servicing payments, thereby leaving more resources for reducing taxes and funding valued programs and services. A lower debt burden also lessens the exposure of Canada's fiscal situation to economic shocks, especially an increase in interest rates or prolonged slowdowns in economic activity. And a lower debt burden reduces the amount that younger Canadians will have to pay for servicing debt incurred by the generations that preceded them.

The financial data in this report are based, for the first time, on the full accrual basis of accounting. This is a major accomplishment, involving all government departments and agencies. Previously, the Government's financial statements were prepared under modified accrual accounting. Full accrual accounting provides a more comprehensive reporting of assets and liabilities and a more transparent picture of the Government's financial position. It is the accounting standard recommended for senior levels of government in Canada by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants and has been strongly recommended by the Auditor General of Canada and the House of Commons Standing Committee on Public Accounts.

The financial data in this report are based on the audited results, which will appear in more detail in the 2003 *Public Accounts of Canada*, scheduled for tabling in the House of Commons this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 2002 to March 31, 2003) and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* publication has been updated to incorporate accrual results for the 1983–84 to 2002–03 period and historical revisions to the *National Economic and Financial Accounts* published by Statistics Canada. These tables are an integral part of this report.

The Honourable John Manley, P.C., M.P.
Deputy Prime Minister and Minister of Finance

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Note to Readers

The financial statements for 2002–03 are presented on the full accrual basis of accounting, replacing the modified accrual standard that had been used since the mid-1980s. The Government first announced its commitment to full accrual accounting in the 1995 budget. The Canadian Institute of Chartered Accountants and the Auditor General of Canada have strongly supported the implementation of full accrual accounting by the Government of Canada. After extensive consultations with the Office of the Auditor General of Canada, the Government felt that it had sufficient assurance as to the reliability of the accrual amounts to implement it in the 2003 budget.

Under full accrual accounting, the Government's financial statements will provide a more comprehensive and up-to-date picture of the Government's financial situation, thereby improving transparency and accountability.

- The Government's balance sheet will provide a more comprehensive picture of the Government's assets and liabilities. For example, the value of the buildings that the Government owns will now appear on its balance sheet, as will its liabilities for cleaning up contamination on its properties.
- The annual budgetary balance will better reflect the impact of economic events and government decisions during the fiscal year. For example, year-to-year changes in recorded tax revenues will more accurately reflect the year-to-year changes in the tax base and tax rates, as these changes will be much less affected by collection and remittance lags.
- The annual budgetary balance will better reflect the impact of government decisions during the fiscal year. In particular, decisions that result in an increase (or decrease) in the Government's liabilities for environmental cleanups in areas of federal jurisdiction, liabilities related to Aboriginal claims, and liabilities for post-employment and retirement benefits for federal employees will be recorded as expenses in the year the decision is made. Under modified accrual accounting, the full costs of some of these decisions would not be recorded in the Government's financial statements until the resulting cash payments were made, which could be many years later.

The Government's previous accounting standard—modified accrual—used a mix of accrual and cash accounting, depending on the type of transaction. In the 2003 budget, and with these financial statements, the Government is extending the use of accrual accounting to all items that were previously recorded on a cash basis. These include:

- *Non-financial assets:* Under modified accrual accounting, the value of the Government's stock of capital assets, such as buildings, vehicles and equipment, was not shown on the balance sheet. Instead the full purchase price of a capital asset was recorded as an expenditure in the year of purchase and therefore had an immediate impact on the budgetary balance in that year. Under full accrual accounting, the value of these assets will now be recorded as a non-financial asset. In addition, the cost of using that asset will be amortized (depreciated) over its estimated useful life according to Generally Accepted Accounting Principles. Similarly, under modified accrual, the cost of an item held in inventory is recognized in the year in which it is purchased while, under full accrual, it is recognized as an expense in the year that it is used.
- *Tax revenues:* Under modified accrual accounting, tax revenues were recorded when they were received, while refunds were recorded in the year in which they were paid. Under full accrual accounting, tax receipts and refunds will generally be recorded in the year in which the taxable activity takes place. Accordingly, a receivable is established for taxes owing and a payable for refunds owing to taxpayers.

- *Liabilities:* Under full accrual accounting, a more comprehensive list of liabilities is recorded on the balance sheet. The Government now includes the estimated cost of environmental cleanups in areas of federal jurisdiction; the value of liabilities related to Aboriginal claims to the extent payment is likely and estimable; increased liabilities for post-employment benefits for federal employees, including workers' compensation and veterans' disability costs; and federal employee retirement costs such as health and dental care.

The Government's fiscal anchor remains the budgetary balance, which will now reflect the impact of the annual changes in the areas described above. Furthermore, prior to the shift to accrual accounting, there was no distinction between net debt and the accumulated deficit, or federal debt, so these terms were used interchangeably. Under full accrual accounting, this is no longer the case. Net debt is the Government's net liabilities excluding the value of its non-financial assets. The accumulated deficit takes into account the value of non-financial assets. The two indicators now represent different measures of the Government's financial position. The federal debt will now represent the accumulation of surpluses and deficits in the past and is the Government's key measure of debt.

The financial results in this publication are based on the audited results, which will appear in more detail in the 2003 *Public Accounts of Canada*. In completing the audit for 2001–02, certain adjustments have been made to the estimates that appeared in *The Budget Plan 2003*. In Budget 2003, the surplus for 2001–02, on a full accrual basis of accounting, was estimated at $8.2 billion. This was based on preliminary estimates, which had not been audited. The audited results have resulted in a lower surplus for 2001–02—$7.0 billion—primarily due to revisions to the estimates for inventories, veterans' disability liabilities and the allowance for tax receivables. Revised estimates have been prepared going back to 1983–84. These appear in the *Fiscal Reference Tables—October 2003*.

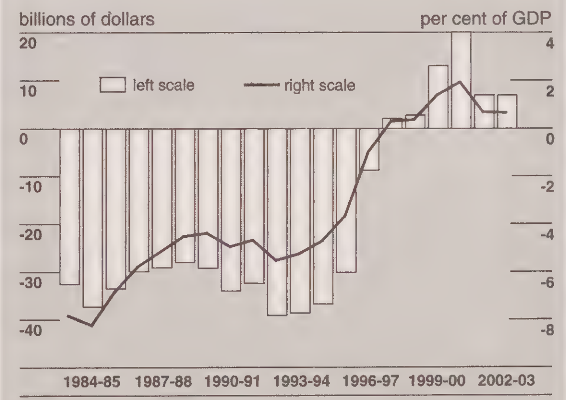
REPORT HIGHLIGHTS

- On a full accrual basis of accounting, a budgetary surplus of $7.0 billion was achieved in 2002–03. This marks the sixth consecutive year the federal budget has been in surplus.
- The shift to full accrual accounting has also resulted in the surplus for 2001–02 being lowered from $8.9 billion (under the previous basis of accounting) to $7.0 billion. Taken together, federal debt has been reduced by $52.3 billion over the last six years.
- Federal debt stood at $510.6 billion at the end of 2002–03. The federal debt-to-GDP (gross domestic product) ratio is now 44.2 per cent, down sharply from its peak of 68.4 per cent in 1995–96. It is now at its lowest level since 1984–85.
- Market debt—the debt issued on credit markets—as a percentage of GDP has declined to 38.1 per cent from the peak of 57.0 per cent in 1996–97.
- The revenue-to-GDP ratio declined in 2002–03 to 15.4 per cent. It has fallen by about 1½ percentage points since 2000–01, reflecting the impact of the tax reductions announced in the February 2000 budget and October 2000 *Economic Statement and Budget Update*.
- Program expenses increased by 6.6 per cent, or $8.3 billion, in 2002–03, of which nearly two-thirds is due to increased transfers to the provinces and territories under the health care agreements reached by first ministers in September 2000 and February 2003. As a percentage of GDP, program expenses increased to 11.5 per cent in 2002–03 from 11.3 per cent in 2001–02—well below the ratio of 15.7 per cent in 1993–94.
- Public debt charges declined by $2.4 billion in 2002–03. As a percentage of revenues, public debt charges were 21 per cent in 2002–03, down from its peak of about 39 per cent in 1990–91. It is now at its lowest level since the late 1970s.

The Budgetary Balance

Sound financial management played an important role in helping Canada avoid a recession in 2001–2002, despite global economic weakness. It enabled fiscal and monetary policy to provide timely support to the Canadian economy through lower taxes and interest rates. The commitment to fiscal discipline allowed Canada to post a budgetary surplus in 2002, while all other G-7 countries recorded deficits. It also helped Canada record the best economic performance among the G-7 countries in 2002. Economic growth in Canada in 2002 rebounded to 3.3 per cent from 1.9 per cent in 2001, primarily due to strong domestic demand, as the external sector remained weak in the face of an uneven global economic recovery. Canada's resilient performance in 2002 reflected strong economic fundamentals, the impact of the year 2000 tax cuts and an increasingly competitive business sector.

Budgetary Balance



Sources: *Public Accounts of Canada* and Statistics Canada.

In the December 2001 and February 2003 budgets, the Government committed to a balanced budget or better for 2002–03. This was after responding to a number of key priorities relating to security in the aftermath of the terrorist attacks of September 11, 2001, and investments in Canada's health care system. In the 2003 budget the Government announced initiatives totalling $6.4 billion for 2002–03, of which $4.7 billion was directed to health care. On a full accrual basis of accounting, the final budgetary surplus for 2002–03 was $7.0 billion, unchanged from the restated surplus for 2001–02.

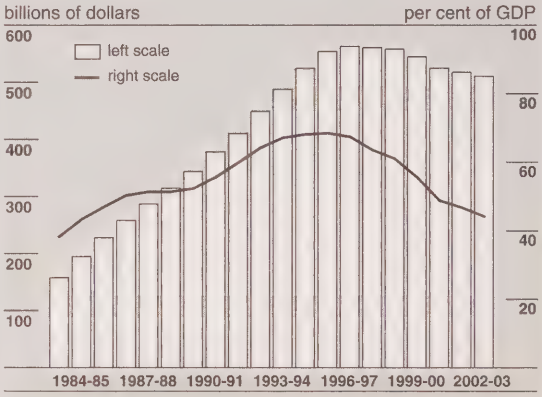
On a full accrual basis of accounting, the budgetary balance went from a deficit of 5.5 per cent of GDP ($38.5 billion) in 1993–94 to six consecutive surpluses over the 1997–98 to 2002–03 period. The 2002–03 surplus was $7.0 billion, or 0.6 per cent of GDP. All of this fiscal improvement since 1993–94 is attributable to the decline in total expenses. As a percentage of GDP, program expenses declined from 15.7 per cent in 1993–94 to 11.5 per cent in 2002–03, and public debt charges fell from 5.5 per cent in 1993–94 to 3.2 per cent in 2002–03.

Federal Debt

The 2002–03 surplus of $7.0 billion brings the federal debt—the accumulation of annual deficits and surpluses—down to $510.6 billion from its peak of $562.9 billion in 1996–97. As a share of GDP, federal debt dropped to 44.2 per cent in 2002–03, down nearly 25 percentage points from the peak of 68.4 per cent in 1995–96. This is the seventh consecutive year in which the federal debt-to-GDP ratio has declined, bringing it to its lowest level since 1984–85.

Federal debt consists of interest-bearing debt and other liabilities, net of financial and non-financial assets. Interest-bearing debt, in turn, consists of unmatured, or market, debt and the Government's obligations to internally held accounts—primarily the liabilities for the federal government employees' pension plans. Of the decrease in the federal debt of $7.0 billion in 2002–03, total interest-bearing debt declined by $2.1 billion: market debt declined by $2.5 billion and obligations to pension accounts increased by $0.4 billion. Other liabilities fell by $2.1 billion, while financial assets increased by $1.9 billion and non-financial assets by $0.9 billion.

Federal Debt (Accumulated Deficit)



Sources: *Public Accounts of Canada* and Statistics Canada.

Federal Debt (Accumulated Deficit)

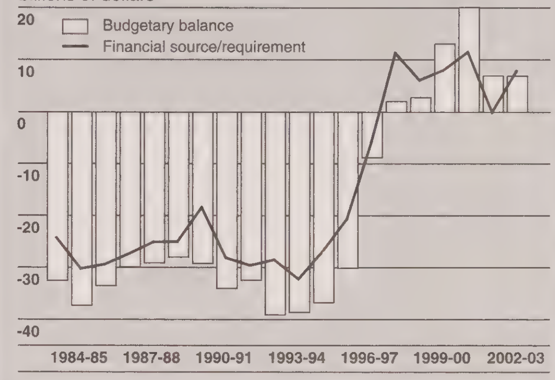
The financial statements of the Government of Canada are now presented on a full accrual basis of accounting. Under the previous accounting standard—modified accrual accounting—net debt and the accumulated deficit were identical. Under the new standard, net debt now includes a comprehensive costing for financial liabilities but excludes non-financial assets. The accumulated deficit includes both. It is the sum of all surpluses and deficits in the past.

Federal debt, referred to in the budget documents and the *Annual Financial Report of the Government of Canada*, is the accumulated deficit. It is the federal government's main measure of debt, as annual changes in this measure determine the budgetary balance.

Financial Source/Requirement

The financial source/requirement measures the difference between cash coming in to the Government and cash going out. There was a financial source of $7.6 billion in 2002–03, compared to a revised financial requirement of $0.3 billion in 2001–02. This turnaround was primarily attributable to swings in the Exchange Fund Account and other accounts.

Budgetary Balance and Financial Source/Requirement



Sources: *Public Accounts of Canada* and Statistics Canada.

Table 1
Financial Highlights[1]

	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03
			($ billions)			
Budgetary transactions						
Revenues	152.1	156.1	166.1	182.7	171.7	177.6
Expenses						
Program expenses	-106.9	-110.0	-109.6	-118.7	-125.0	-133.3
Public debt charges	-43.1	-43.3	-43.4	-43.9	-39.7	-37.3
Total expenses	-150.0	-153.3	-153.0	-162.6	-164.7	-170.6
Budgetary balance	**2.1**	**2.8**	**13.1**	**20.2**	**7.0**	**7.0**
Non-budgetary transactions	9.0	3.1	-5.3	-8.9	-7.3	0.7
Financial source/requirement	11.1	5.9	7.8	11.3	-0.3	7.6
Net change in financing activities	-9.6	-6.9	-4.0	-10.0	-4.1	-2.5
Net change in cash balances	1.5	-1.0	3.8	1.3	-4.4	5.1
Cash balance at end of period	11.7	10.7	14.5	15.8	11.4	16.5
Financial position						
Total liabilities	713.4	717.7	717.3	715.0	704.3	700.1
Total financial assets	102.5	108.2	120.7	138.7	133.4	135.3
Net debt	610.9	609.5	596.6	576.3	570.9	564.8
Non-financial assets	50.2	51.7	51.8	51.7	53.4	54.2
Federal debt (accumulated deficit)	560.7	557.9	544.7	524.6	517.5	510.6
Financial results (% of GDP)						
Budgetary revenues	17.2	17.1	16.9	17.0	15.5	15.4
Program expenses	12.1	12.0	11.2	11.0	11.3	11.5
Public debt charges	4.9	4.7	4.4	4.1	3.6	3.2
Budgetary balance	0.2	0.3	1.3	1.9	0.6	0.6
Federal debt	63.5	61.0	55.4	48.8	46.7	44.2

[1] Reflects classification changes resulting from the move to full accrual accounting.

Budgetary Revenues

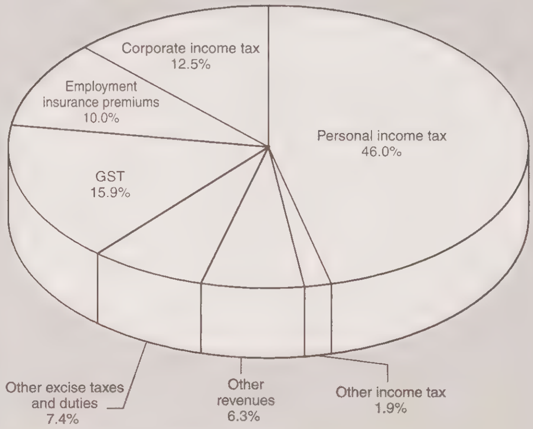
Following a decline of $11.1 billion, or 6.1 per cent, in 2001–02, budgetary revenues increased in 2002–03 by $5.9 billion, or 3.4 per cent. The decline in 2001–02 was primarily attributable to the impact of global economic weakness on the various tax bases, an adjustment relating to refundable taxes withheld from the federal Retirement Compensation Arrangements Account that were previously credited to tax revenues, and the effect of the tax reduction measures announced in the February 2000 budget and October 2000 *Economic Statement and Budget Update*.

Nominal income—the applicable tax base for revenues—advanced by 4.3 per cent in 2002, up from the increase of 3.0 per cent in 2001. The net impact of stronger economic growth in 2002 on revenues was dampened by the incremental impact of the tax reductions introduced in previous budgets, especially the restoration of full indexation of the personal income tax system, increases in the Canada Child Tax Benefit and reductions in the corporate income tax rate. Most of the increase in budgetary revenues resulted from higher excise taxes and duties, particularly goods and services tax (GST) revenues, primarily reflecting strengthened consumer demand.

Personal income tax revenues, the largest component of budgetary revenues, increased by $2.2 billion, or 2.8 per cent, in 2002–03. However, half of this increase is attributable to the one-time adjustment in 2001–02 relating to refundable taxes withheld from the federal Retirement Compensation Arrangements Account. As a result, the underlying increase was only 1.5 per cent. This is broadly in line with the growth of 3.3 per cent in personal income, adjusted for the incremental impact of the tax reduction measures. Personal income growth was impacted in 2002 by lower interest and dividend payments, reflecting the impact of lower interest rates and weakness in the stock market.

Corporate income tax revenues declined by $2.0 billion in 2002–03, or 8.3 per cent, the second consecutive year they have declined. Although corporate profits increased by 4.3 per cent in 2002, the impact of loss carry-forwards due to the decline in profits in 2001, and a reduction in the corporate tax rate from 27 to 25 per cent effective January 1, 2002, and from 25 to 23 per cent effective January 1, 2003, resulted in a decline in revenues in 2002–03.

Composition of Net Revenues for 2002–03



Source: *Public Accounts of Canada.*

Other taxes and duties increased $4.2 billion, or 11.4 per cent.

- GST revenues increased $3.0 billion, or 11.7 per cent. This increase was fuelled primarily by strong growth in consumer demand, especially durable goods and new housing.
- Customs import duties increased $0.2 billion, or 6.0 per cent, reflecting a strong increase in imports subject to tariffs.
- Energy taxes were up 3.0 per cent, while the impact of tobacco excise tax increases in late 2001 and early 2002 account for most of the increase of $0.5 billion, or 13.2 per cent, in other excise taxes and duties. The Air Travellers Security Charge came into effect April 1, 2002. The revenues from this charge are used to fund the new air security initiatives announced in the 2001 budget.

Table 2
Revenues

	2001–02	2002–03	Net change	
		($ millions)		(%)
Tax revenues				
Net income tax collections				
Personal income tax	79,501	81,707	2,206	2.8
Corporate income tax	24,242	22,222	-2,020	-8.3
Other income tax revenues	2,925	3,291	366	12.5
Total	106,668	107,220	552	0.5
Other taxes and duties				
Goods and services tax	25,292	28,248	2,956	11.7
Customs import duties	3,040	3,221	181	6.0
Energy taxes	4,848	4,992	144	3.0
Air Travellers Security Charge		421	421	
Other excise taxes and duties	3,953	4,475	522	13.2
Total	37,133	41,357	4,224	11.4
Net tax revenues	**143,801**	**148,577**	**4,776**	**3.3**
Employment insurance premium revenues	17,637	17,870	233	1.3
Net other revenues				
Crown corporation revenues	3,172	3,478	306	9.6
Foreign exchange revenues	2,453	3,379	926	37.7
Other revenues	4,625	4,258	-367	-7.9
Total	10,250	11,115	864	8.4
Net budgetary revenues	**171,688**	**177,561**	**5,873**	**3.4**

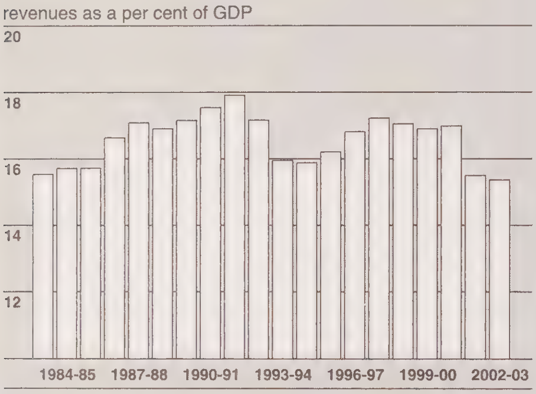
Employment insurance premium revenues were up $0.2 billion, or 1.3 per cent, as the reduction in premium rates was more than offset by the increase in the number of people employed and therefore paying premiums. The employee premium rate (per $100 of insurable earnings) was reduced from $2.25 for 2001 to $2.20 for 2002 and to $2.10 for 2003 (with a corresponding decline in the employer rate).

Other revenues consist of net gains/losses from Crown corporations, such as the Bank of Canada, Export Development Canada and Canada Mortgage and Housing Corporation; foreign exchange revenues; and other revenues, primarily revenues from the sales of goods and services. An increase of $0.9 billion, or 8.4 per cent, was recorded in this component, primarily reflecting higher foreign exchange revenues and higher profits from enterprise Crown corporations.

The revenue ratio—budgetary revenues as a percentage of GDP—represents an approximate measure of the overall federal "tax burden" in that it compares the total of all federal revenues collected to the size of the economy. The revenue ratio stood at 15.4 per cent in 2002–03, about 1½ percentage points below the ratio in 2000–01. The decline in the ratio since 2000–01 primarily reflects the impact of the tax reductions announced in the February 2000 budget and the October 2000 *Economic Statement and Budget Update*.

It should be noted that some components of income subject to taxation are excluded from the Statistics Canada measure of GDP, such as capital gains and income from trusteed pension plans. As a result, this ratio overstates the tax burden. In addition, the sharp rise in capital gains and the growth in income from trusteed pension plans due to the aging of the population distort year-to-year changes in the ratio. Therefore, caution should be exercised in interpreting this ratio.

Revenue Ratio



Sources: Department of Finance and Statistics Canada.

The figures in Table 2 are presented on a "net" basis, reflecting the way in which revenues and expenses are presented to Parliament in the Government's annual budget. In this presentation, the Canada Child Tax Benefit is netted against income tax revenues. Certain departmental revenues, such as the revenues of consolidated Crown corporations and revenues levied by departments for specific services, including the contract costs of policing services in provinces, are netted against expenses. This classification has the effect of reducing both revenues and expenses but has no impact on the budgetary balance. Table 3 shows the impact of "grossing up" budgetary revenues for these adjustments. In 2002–03, they amounted to $12.7 billion, of which $7.8 billion was due to the Canada Child Tax Benefit. As a result, gross budgetary revenues were $190.2 billion in 2002–03, up 3.6 per cent from 2001–02.

Table 3

Gross Budgetary Revenues

	2001–02	2002–03	Net change	
		($ millions)		(%)
Net budgetary revenues	**171,688**	**177,561**	**5,873**	**3.4**
Adjustments				
Canada Child Tax Benefit	7,471	7,823	352	4.7
Revenues netted against program expenses	2,935	3,020	84	2.9
Revenues of consolidated Crown corporations	1,582	1,827	245	15.5
Net adjustment	11,988	12,670	682	5.7
Gross budgetary revenues	**183,676**	**190,232**	**6,556**	**3.6**

Total Expenses

Total expenses consist of two components—public debt charges and program expenses. In 2002–03 total expenses amounted to $170.6 billion, up $5.9 billion, or 3.6 per cent, from 2001–02 (Table 4). Public debt charges declined by $2.4 billion, or 6.0 per cent, while program expenses advanced $8.3 billion, or 6.6 per cent. Of this increase, $5.3 billion, or nearly two-thirds, was due to higher transfers to the provinces under the September 2000 and February 2003 health agreements.

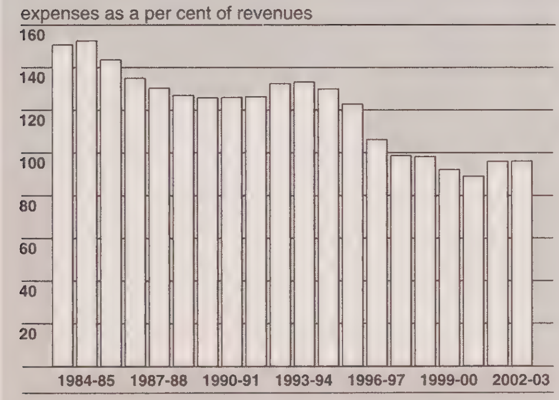
The expense ratio—total expenses as a percentage of net budgetary revenues—stood at 96.1 per cent in 2002–03, up marginally from 2001–02. In 1993–94 the expense ratio stood at 133.2 per cent.

Public debt charges declined by $2.4 billion, or 6.0 per cent, to $37.3 billion in 2002–03, primarily attributable to a decline in the stock of interest-bearing debt and lower average effective interest rates on that debt.

- The average effective interest rate on the Government's interest-bearing debt (unmatured debt and pension liabilities) was 6.2 per cent in 2002–03, compared to 6.4 per cent in 2001–02. The average effective interest rate was 5.3 per cent on unmatured debt and 8.5 per cent on pension and other accounts.
- The stock of total interest-bearing debt declined by $2.1 billion, from $622.9 billion in 2001–02 to $620.8 billion in 2002–03, as the stock of market debt declined by $2.5 billion to $439.8 billion, while liabilities to pension and other accounts increased by $0.4 billion to $181.0 billion.

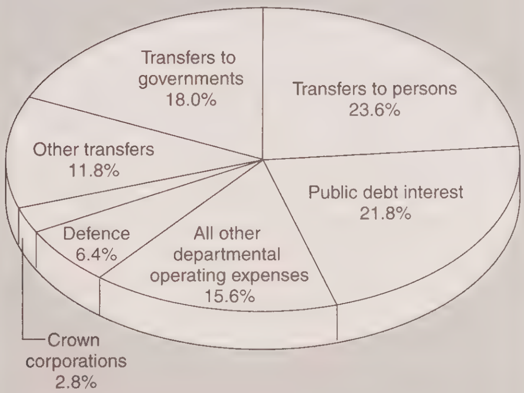
The interest ratio—public debt charges as a percentage of net budgetary revenues—declined from 23.1 per cent in 2001–02 to 21.0 per cent in 2002–03. This ratio means that, in 2002–03, the Government spent 21 cents of every revenue dollar on interest on the public debt. This is down from the peak of 38.7 cents in 1990–91 and is the lowest this ratio has been since the late 1970s. This is money that must be paid to meet the Government's ongoing obligations on its debt. The lower the ratio, the more flexibility the Government has to address the key priorities of Canadians.

Expense Ratio



Source: Department of Finance.

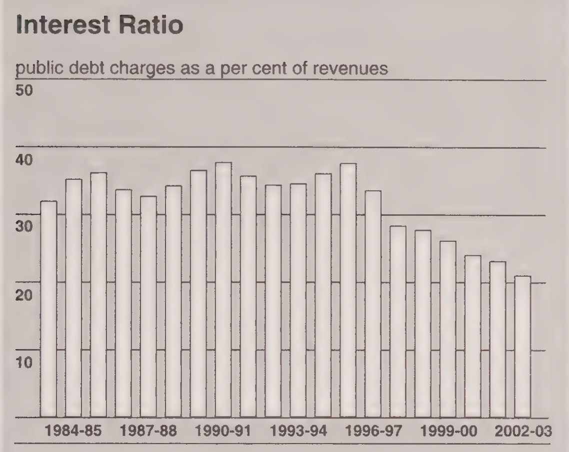
Composition of Net Expenses for 2002–03



Source: *Public Accounts of Canada.*

Table 4
Total Expenses

	2001–02	2002–03	Net change	
		($ millions)		(%)
Transfer payments				
Major transfers to persons				
Elderly benefits	24,641	25,692	1,051	4.3
Employment insurance benefits	13,726	14,496	770	5.6
Total	38,367	40,188	1,821	4.7
Major transfers to other levels of government				
Canada Health and Social Transfer	17,300	18,600	1,300	7.5
Canada Health and Social Transfer supplement		2,500	2,500	
Diagnostic/Medical Equipment Fund		1,500	1,500	
Fiscal arrangements	11,978	10,366	-1,612	-13.5
Alternative Payments for Standing Programs	-2,662	-2,321	341	-12.8
Total	26,616	30,645	4,029	15.1
Subsidies and other transfers				
Agriculture and Agri-Food	1,897	2,654	757	39.9
Foreign Affairs and International Trade	2,405	2,456	51	2.1
Health Canada	1,617	1,619	2	0.1
Human Resources Development	1,698	1,602	-96	-5.7
Indian Affairs and Northern Development	4,557	4,649	92	2.0
Industry/regional agencies	2,628	2,322	-306	-11.6
Canada Foundation for Innovation		500	500	
Canada Health Infoway		600	600	
Other	3,519	3,674	155	4.4
Total	18,321	20,076	1,755	9.6
Total transfer payments	83,304	90,909	7,605	9.1
Other program expenses				
Crown corporations				
Canada Mortgage and Housing Corporation	1,910	1,979	69	3.6
Canadian Broadcasting Corporation	983	1,047	64	6.5
Other	1,610	1,699	89	5.5
Total	4,503	4,724	221	4.9
Defence	10,032	10,847	815	8.1
All other departments and agencies	27,178	26,843	-336	-1.2
Total other program expenses	41,714	42,414	700	1.7
Net program expenses	**125,018**	**133,323**	**8,305**	**6.6**
Public debt charges	39,651	37,270	-2,381	-6.0
Net expenses	**164,669**	**170,593**	**5,924**	**3.6**



Source: Department of Finance.

Program expenses amounted to $133.3 billion in 2002–03, an increase of $8.3 billion, or 6.6 per cent, from 2001–02. Higher entitlements to provinces and territories under the Canada Health and Social Transfer (CHST), coupled with the $1.5-billion transfer to the Diagnostic/Medical Equipment Fund, accounted for nearly two-thirds, or $5.3 billion, of the increase in program expenses.

Major transfer payments to persons increased by $1.8 billion, or 4.7 per cent.

- Elderly benefits consist of Old Age Security, Guaranteed Income Supplement and spouse's allowance payments. Total benefits were up $1.1 billion in 2002–03, reflecting both higher average benefits, which are indexed to inflation, and an increase in the number of recipients.
- Employment insurance benefits increased $0.8 billion in 2002–03. About half of this increase is attributable to increased regular benefit payments, reflecting the deterioration in the labour market and the accompanying increase in the number of unemployed. Most of the remaining increase is due to higher special benefits, in particular the increase in parental benefits, reflecting the doubling of parental leave from six months to one year.

Major transfer payments to other levels of government include the CHST, fiscal arrangements (equalization, transfers to the territories, as well as a number of smaller transfer programs) and Alternative Payments for Standing Programs. Transfers increased by $4.0 billion in 2002–03, or 15.1 per cent.

- The CHST—a block-funded transfer—supports health care, post-secondary education, social assistance and social services, including early childhood development. It provides support in the form of cash and tax transfers to the provinces and territories. As part of the September 2000 and February 2003 health agreements, the federal government legislated an incremental $3.8 billion to be paid in 2002–03—of which $2.5 billion was in the form of a special supplement. An additional $1.5-billion investment was provided to the Diagnostic/Medical Equipment Fund to be used by the provinces and territories in support of specialized staff training and equipment, to improve access to publicly funded diagnostic services.
- Total entitlements under fiscal arrangements decreased by $1.6 billion to $10.4 billion, primarily reflecting lower equalization entitlements. The decline in equalization entitlements in 2002–03 reflects stronger-than-expected economic growth in both 2001 and 2002 in the equalization-receiving provinces relative to the non-equalization-receiving provinces and, hence, a convergence in the estimated provincial fiscal capacity of the equalization-receiving provinces relative to the equalization standard. Under the equalization program, the federal government transfers funds to the less prosperous provinces so that they can provide their residents with public services reasonably comparable to those in other provinces without having to resort to higher-than-average taxation.

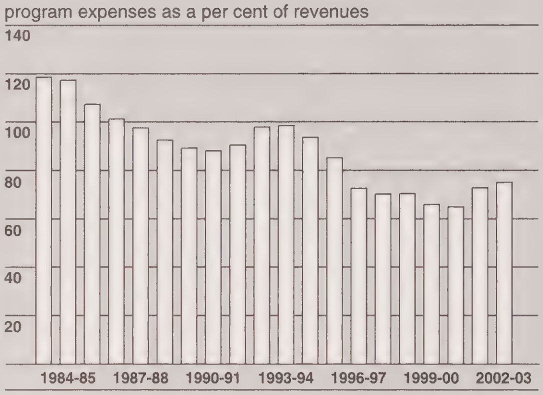
- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allow provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provides provinces with tax points, the value of which are netted against total entitlements and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Subsidies and other transfers advanced by $1.8 billion, or 9.6 per cent. Most of this increase is attributable to increased funding to the Canada Foundation for Innovation ($500 million) and Canada Health Infoway ($600 million), as announced in the February 2003 budget. Liabilities relating to agricultural assistance were up strongly, primarily for crop insurance.

Other program expenses—total program expenses less transfers—consist of expenses related to Crown corporations, and operating expenses of departments and agencies, including National Defence. These expenses amounted to $42.4 billion in 2002–03, up $0.7 billion, or 1.7 per cent, from 2001–02. Within this component:

- Expenses related to Crown corporations were up by $0.2 billion to $4.7 billion in 2002–03. This component includes appropriations to consolidated Crown corporations (those Crown corporations that rely on government funding as their principal source of revenue).

Program Share



Source: Department of Finance.

- Defence expenses increased $0.8 billion, or 8.1 per cent, primarily reflecting incremental funding provided in the 2001 and 2003 budgets.
- All other departmental and agency expenses decreased by $0.3 billion, or 1.2 per cent, in 2002–03, as the 2001–02 results were affected by the inclusion of a number of large one-time liabilities.

The program share—program expenses as a percentage of budgetary revenues—amounted to 75.1 per cent, up from 72.7 per cent 2001–02. In 1993–94 the program share was 98.6 per cent.

The above numbers are presented on a "net" basis, as discussed in the previous section, "Budgetary Revenues." Gross expenses are $12.7 billion higher than net expenses, as shown in Table 5.

Table 5

Gross Expenses

	2001–02	2002–03	Net change	
		($ millions)		(%)
Net expenses	**164,669**	**170,593**	**5,924**	**3.6**
Adjustments				
Canada Child Tax Benefit	7,471	7,823	352	4.7
Revenues netted against expenses	2,936	3,020	84	2.9
Revenues of consolidated Crown corporations	1,582	1,827	245	15.5
Net adjustment	11,988	12,670	682	5.7
Gross expenses	**176,657**	**183,263**	**6,606**	**3.7**

The Budgetary Balance, Financial Source/Requirement and Debt

The budgetary balance is the most comprehensive measure of the federal government's fiscal results. It is presented on a full accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made, and recording tax revenues only when cash is received.

In contrast, the financial source/requirement measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance in that it includes transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, foreign exchange activities, and changes in other financial assets, liabilities and non-financial assets. These activities are included as part of non-budgetary transactions. The conversion from full accrual to cash accounting is also reflected in non-budgetary transactions. Non-budgetary transactions in 2002–03 resulted in a net source of funds amounting to $0.7 billion, compared to a revised net requirement of $7.3 billion in 2001–02. The improvement reflects a turnaround in foreign exchange activities and in the pension and other accounts, along with a lower requirement in accounts payable, receivable, accruals and allowances. With the shift to full accrual accounting, a number of classification changes have been incorporated, whereby foreign exchange activities are now part of non-budgetary transactions.

With a budgetary surplus of $7.0 billion and a source of funds from non-budgetary transactions of $0.7 billion, there was a financial source of $7.6 billion in 2002–03, up from the revised financial requirement of $0.3 billion in 2001–02.

With this financial source, the Government retired $2.5 billion of its market debt and increased its cash balances by $5.1 billion. Cash balances at March 31, 2003, stood at $16.5 billion.

Total liabilities consist of interest-bearing debt and other liabilities. Interest-bearing debt includes market debt and liabilities for pension and other accounts. At March 31, 2003, interest-bearing debt amounted to $620.8 billion, down $2.1 billion from a year earlier. Other liabilities, which include accounts payable and accrued liabilities, amounted to $79.4 billion, down $2.1 billion from 2001–02. As a result, total liabilities stood at $700.1 billion.

Financial assets consist of cash and accounts receivable, including tax receivables; foreign exchange accounts; and loans, investments and advances. Financial assets totalled $135.3 billion at March 31, 2003, up $1.9 billion from March 31, 2002. As a result, net debt stood at $564.8 billion at March 31, 2003, down $6.1 billion from March 31, 2002, and $47.5 billion below the peak of $612.3 billion at March 31, 1997.

Table 6

Budgetary Balance, Financial Source/Requirement and Net Financing Activities

	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03
			($ billions)			
Surplus for the year	**2.1**	**2.8**	**13.1**	**20.2**	**7.0**	**7.0**
Non-budgetary transactions						
Pension and other accounts						
Public sector pensions (net)	3.3	5.0	5.9	0.8	-2.3	-1.2
Canada Pension Plan	0.5	1.2	0.8	0.2	0.4	0.3
Other	0.3	1.4	0.5	1.9	0.9	1.3
Total	4.1	7.6	7.2	2.9	-1.0	0.4
Capital investing activities	-3.0	-3.7	-2.5	-2.0	-4.4	-4.8
Other investing activities	4.9	2.9	2.7	1.0	1.9	0.8
Other activities						
Accounts payable, receivable, accruals and allowances	2.8	-0.3	-8.1	-4.4	-4.6	-2.2
Foreign exchange activities	-2.2	-5.7	-6.8	-8.8	-1.8	3.1
Amortization of tangible capital assets	2.3	2.3	2.3	2.3	2.6	3.3
Total other activities	3.0	-3.7	-12.7	-10.8	-3.8	4.2
Total non-budgetary transactions	9.0	3.1	-5.3	-8.9	-7.3	0.7
Financial source/requirement	**11.1**	**5.9**	**7.8**	**11.3**	**-0.3**	**7.6**
Net change in financing activities						
Marketable bonds	15.8	9.6	-0.9	1.0	-1.1	-5.6
Treasury bills	-23.1	-15.4	2.9	-11.2	5.5	10.4
Canada Savings Bonds	-2.7	-2.1	-1.2	-0.4	-2.3	-1.4
Other	0.5	1.0	-4.9	0.5	-6.2	-5.9
Total	-9.6	-6.9	-4.0	-10.0	-4.1	-2.5
Change in cash balances	1.5	-1.0	3.8	1.3	-4.4	5.1
Cash in bank (March 31)	11.7	10.7	14.5	15.8	11.4	16.5

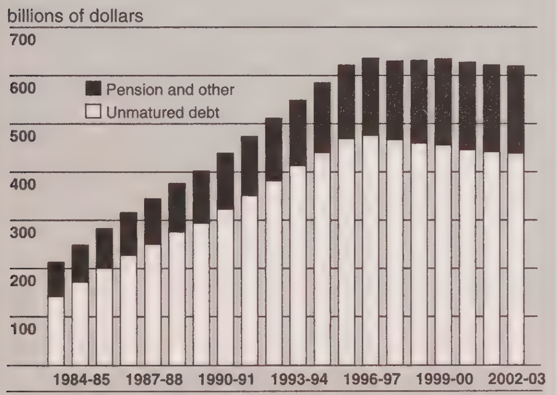
With the implementation of full accrual accounting, the Government is now including the value of its non-financial assets, such as capital assets and inventories, on its balance sheet. At March 31, 2003, non-financial assets amounted to $54.2 billion, up $0.8 billion from a year earlier. As a result, the federal debt (accumulated deficit) stood at $510.6 billion at March 31, 2003, down a total of $52.3 billion from its peak in 1996–97.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $84.7 billion at the end of March 2003. This represents 19.3 per cent of the Government's total market debt.

Table 7
Outstanding Debt at Year-End

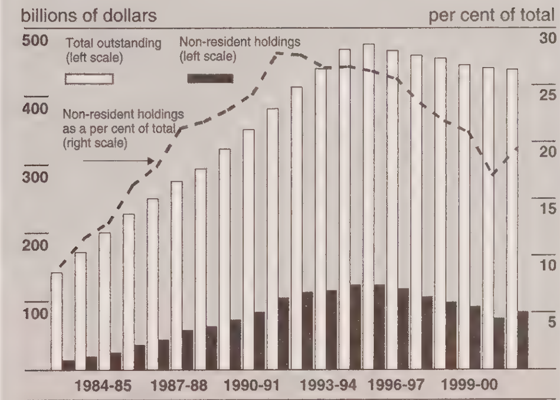
	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03
			($ billions)			
Liabilities						
Accounts payable and accrued liabilities	82.2	85.8	82.2	87.0	81.5	79.4
Interest-bearing debt						
Unmatured debt	467.3	460.4	456.4	446.4	442.3	439.8
Pension and other accounts	163.9	171.5	178.7	181.6	180.6	181.0
Total	631.2	631.9	635.1	628.0	622.9	620.8
Total liabilities	713.4	717.7	717.3	715.0	704.3	700.1
Financial assets						
Cash and accounts receivable	55.2	55.9	61.0	67.0	59.8	62.6
Foreign exchange accounts	29.0	34.7	41.5	50.3	52.0	49.0
Loans, investments and advances	18.4	17.6	18.2	21.4	21.6	23.7
Total financial assets	102.5	108.2	120.7	138.7	133.4	135.3
Net debt	**610.9**	**609.5**	**596.6**	**576.3**	**570.9**	**564.8**
Non-financial assets						
Tangible capital assets	43.3	44.6	44.6	44.2	45.7	47.0
Inventories	6.0	6.1	6.3	6.6	6.4	6.1
Prepaid expenses	0.9	0.9	0.9	0.9	1.2	1.1
Total non-financial assets	50.2	51.7	51.8	51.7	53.4	54.2
Federal debt (accumulated deficit)	**560.7**	**557.9**	**544.7**	**524.6**	**517.5**	**510.6**

Interest-Bearing Debt



Source: *Public Accounts of Canada.*

Foreign Holdings of Government of Canada Market Debt



Source: Bank of Canada.

Comparison of Actual Budgetary Outcomes to Budget Estimates

This section compares the actual outcome for the major components of the budgetary balance for 2002–03 to the estimates presented in the February 2003 budget. As the estimates contained in the December 2001 budget for 2002–03 were not presented on a full accrual basis, no attempt will be made to provide a reconciliation to those estimates.

The Government targeted a balanced budget for 2002–03 in the February 2003 budget. Under the Debt Repayment Plan, the fiscal target for each year is based on:

- Using the average of private sector economic forecasts for budget-planning purposes.
- Including an annual Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. It is not a source of funding for new policy initiatives. If not needed, it is used to pay down the public debt. For 2002–03 the Contingency Reserve was set at $3 billion in the February 2003 budget.
- Adding an extra degree of economic prudence to provide further assurance against falling back into deficit. No additional prudence was added in the February 2003 budget for 2002–03, given that the fiscal year was nearly over.

After accounting for the fiscal impact of the new spending initiatives and tax cuts, the February 2003 budget estimated a balanced budget or better in 2002–03. This target was backed by the normal $3-billion Contingency Reserve.

On a full accrual basis of accounting, the final audited budgetary surplus for 2002–03 was $7.0 billion. This improvement is primarily attributable to one-time factors affecting program expenses. Within program expenses, all other expenses were $2.5 billion lower than estimated in the February 2003 budget, primarily reflecting one-time adjustments to allowances for loans to foreign countries, and revisions to the accrual adjustments. Entitlements under the fiscal arrangements programs, primarily equalization entitlements, were also lower than estimated at the time of the 2003 budget. Data revisions since the budget indicated a narrowing of fiscal disparities between the equalization- and non-equalization-receiving provinces, which resulted in lower equalization entitlements for both 2001–02 and 2002–03. The downward adjustment in 2002–03, therefore, incorporates both the prior-year revisions as well as those in 2002–03. In addition, employment insurance benefits were $0.5 billion lower than expected, while elderly benefits were $0.1 billion lower.

In contrast, budgetary revenues were $1.2 billion lower than estimated in the February 2003 budget, primarily attributable to lower-than-expected personal income tax revenues. Offsetting some of this decline were higher net gains from enterprise Crown corporations and exchange fund activities. Public debt charges were marginally lower than expected.

Table 8

Comparison of Actual Outcomes to February 2003 Budget

	Actual	2003 budget	Difference
		($ billions)	
Budgetary revenues			
Personal income tax	81.7	84.2	-2.5
Corporate income tax	22.2	21.9	0.3
Other income tax	3.3	2.9	0.4
Excise taxes and duties	41.4	41.6	-0.2
Employment insurance premium revenues	17.9	18.3	-0.4
Non-tax revenue	11.1	9.8	1.3
Total	177.6	178.7	-1.2
Program expenses			
Major transfers to persons			
Elderly benefits	25.7	25.8	-0.1
Employment insurance benefits	14.5	15.0	-0.5
Major transfers to other levels of government			
Canada Health and Social Transfer	22.6	22.6	0.0
Fiscal arrangements	10.4	12.7	-2.4
Alternative Payments for Standing Programs	-2.3	-2.5	0.2
All other expenses	62.5	65.0	-2.5
Total	133.3	138.6	-5.2
Public debt charges	37.3	37.2	0.1
Budgetary outcome/estimate	**7.0**	**3.0**	**4.0**

Report of the Auditor General on the Condensed Financial Statements of the Government of Canada

To the Minister of Finance:

The accompanying condensed statements of operations and accumulated deficit, financial position, change in net debt and cash flow are derived from the complete financial statements of the Government of Canada as at March 31, 2003, and for the year then ended on which I expressed an opinion without reservation in my Report to the House of Commons dated September 29, 2003.

My Report drew two matters I have raised before to Parliament's attention: a concern about the Employment Insurance Account, and the recording of transfers to Foundations. For more complete information, readers should refer to my Report, which will be included in Volume I of the 2003 *Public Accounts of Canada*, expected to be tabled in the House of Commons later this year.

The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility, in accordance with the applicable Assurance Guideline of The Canadian Institute of Chartered Accountants, is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria described in the Guideline referred to above.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and cash flow, reference should be made to the related complete financial statements, which will also be included in Volume I of the 2003 *Public Accounts of Canada*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
September 29, 2003

CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs and resources for which the Government is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the Government.

These financial statements are extracted and condensed from the audited financial statements included in Section 2 of Volume I of the 2003 *Public Accounts of Canada*, which are expected to be tabled in Parliament later this year. As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 9

Government of Canada
Condensed Statement of Operations and Accumulated Deficit for the Year Ended March 31, 2003

	2003		Restated 2002
	Budget[1]	Actual	Actual
		($ millions)	
Revenues			
Income tax	117,000	115,043	114,139
Other taxes and duties	41,600	41,357	37,133
Employment insurance premiums	18,300	17,870	17,637
Other revenues	14,200	15,962	14,767
Total revenues	***191,100***	***190,232***	***183,676***
Expenses			
Transfer payments			
Old Age Security and related payments	25,800	25,692	24,641
Other levels of government	32,800	30,645	26,616
Employment insurance benefits	15,000	14,496	13,726
Other transfer payments	28,000	27,899	25,792
	101,600	98,732	90,775
Other program expenses	49,400	47,261	46,231
Total program expenses	***151,000***	***145,993***	***137,006***
Interest on debt	37,100	37,270	39,651
Total expenses	***188,100***	***183,263***	***176,657***
Annual surplus	**3,000**[2]	**6,969**	**7,019**
Accumulated deficit, beginning of year—previously reported		517,545	545,396
Changes in accounting policies (see note 2 on page 28)			20,832
Accumulated deficit, beginning of year—restated		517,545	524,564
Accumulated deficit, end of year		**510,576**	**517,545**

1 Derived from Budget 2003 and adjusted to a gross basis.

2 In Budget 2003 the surplus for the year is equivalent to the Contingency Reserve.

Table 10

Government of Canada
Condensed Statement of Financial Position
as at March 31, 2003

	2003	Restated 2002
	($ millions)	
Liabilities		
Accounts payable and accrued liabilities	79,384	81,453
Interest-bearing debt		
Unmatured debt		
Payable in Canadian currency	418,611	415,239
Payable in foreign currencies	21,141	27,032
Total	439,752	442,271
Pension and other liabilities		
Public sector pensions	125,708	126,921
Other employee and veteran future benefits	38,844	38,280
Other	16,452	15,417
Total	181,004	180,618
Total interest-bearing debt	*620,756*	*622,889*
Total liabilities	***700,140***	***704,342***
Financial assets		
Cash and accounts receivable	62,626	59,833
Foreign exchange accounts	48,950	52,046
Loans, investments and advances		
Enterprise Crown corporations and other government business enterprises	14,555	13,688
Other	18,631	17,355
Allowance for valuation	(9,438)	(9,487)
Total loans, investments and advances	*23,748*	*21,556*
Total financial assets	***135,324***	***133,435***
Net debt	***564,816***	***570,907***
Non-financial assets		
Tangible capital assets	47,034	45,724
Other	7,206	7,638
Total non-financial assets	***54,240***	***53,362***
Accumulated deficit	**510,576**	**517,545**

Table 11

Government of Canada Condensed Statement of Change in Net Debt for the Year Ended March 31, 2003

	2003		Restated 2002
	Budget[1]	Actual	Actual
		($ millions)	
Net debt, beginning of year—previously reported	570,900	570,907	545,396
Changes in accounting policies (see note 2 on page 28)			30,909
Net debt, beginning of year—restated	**570,900**	**570,907**	**576,305**
Change in net debt during the year			
Annual surplus	(3,000)	(6,969)	(7,019)
Acquisition of tangible capital assets	4,400	5,051	4,485
Amortization of tangible capital assets	(3,000)	(3,341)	(2,583)
Other		(832)	(281)
Net decrease in net debt	(1,600)	(6,091)	(5,398)
Net debt, end of year	**569,300**	**564,816**	**570,907**

[1] Derived from Budget 2003.

Table 12

Government of Canada Condensed Statement of Cash Flow for the Year Ended March 31, 2003

	2003	Restated 2002
	($ millions)	
Cash provided by operating activities		
Annual surplus	6,969	7,019
Items not affecting cash	4,620	(4,831)
	11,589	**2,188**
Cash used for capital investment activities	**(4,763)**	**(4,429)**
Cash provided by investing activities	**819**	**1,932**
Total cash generated (required) before financing activities	***7,645***	***(309)***
Cash provided by (used for) financing activities		
Net increase in Canadian currency borrowings	3,372	1,994
Net decrease in foreign currency borrowings	(5,891)	(6,126)
	(2,519)	**(4,132)**
Net increase (decrease) in cash	**5,126**	**(4,441)**
Cash at beginning of year	11,360	15,801
Cash at end of year	**16,486**	**11,360**

Notes to the Condensed Financial Statements

1. Significant Accounting Policies

The Government of Canada reporting entity includes all departments, agencies, corporations and funds which are owned or controlled by the Government and which are accountable to Parliament. The financial activities of all these entities are consolidated in these statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the Government for financing their activities. These corporations are reported under the modified equity basis of accounting. The Canada Pension Plan is excluded from the reporting entity as it is under the joint control of the Government and participating provinces.

The Government accounts for transactions on an accrual basis. Financial assets recorded on the Condensed Statement of Financial Position can provide resources to discharge liabilities or finance future operations and are recorded at the lower of cost or net realizable value. Non-financial assets cannot normally be converted into cash to finance future operations without disrupting government operations; they are recorded at cost less accumulated amortization. Liabilities are recorded at the estimated amount ultimately payable, with public sector pension and other employee and veteran future benefits being determined on an actuarial basis. Valuation allowances are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the Government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable.

Comparative figures for 2002 have been reclassified to conform to the current year's presentation.

2. Changes in Accounting Policies

In 2003 the Government changed its basis of accounting from modified accrual to full accrual. These changes have been applied retroactively, with restatement of the 2002 financial statements. The nature of the changes and their effect on the 2002 opening accumulated deficit and net debt are as follows:

	Accumulated deficit	Net debt
	($ millions)	
Tangible capital assets	-42,785	1,429
Other employee and veteran future benefits	34,466	34,466
Tax revenues	-11,024	-11,024
Other liabilities	10,008	10,008
Inventories and prepaid expenses	-7,527	
Investments in enterprise Crown corporations	-3,970	-3,970
Total effect	-20,832	30,909

The Government also adopted a new financial statement format to reflect the full accrual basis of accounting and introduced a new Statement of Change in Net Debt.

3. Contractual Commitments

Contractual commitments that will materially affect the level of future expenses include transfer payment agreements, acquisitions of goods and services, operating leases and funding of international organizations. At March 31, 2003, contractual commitments amounted to approximately $33 billion ($30 billion in 2002).

4. Contingent Liabilities

Contingent liabilities related to guarantees by the Government and international organizations amount to $75 billion ($77 billion in 2002). There are thousands of claims and pending and threatened litigation cases against the Government; the total amount claimed in these instances is significant but the final outcome is not determinable. Insurance in force relating to self-sustaining insurance programs operated by three enterprise Crown corporations amounted to approximately $646 billion ($615 billion in 2002). The Government expects that it will not incur any costs to cover insurance claims under these programs.

Other Sources of Information

The Public Accounts of Canada

The *Public Accounts of Canada*, as required under section 64(1) of the Financial Administration Act, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in two volumes:

- Volume I contains the Government's audited financial statements and supporting schedules and information; and
- Volume II contains details of financial operations by ministry (Part I) and additional information and analyses (Part II).

The Budget

The budget, usually introduced in February, presents the Government's overall fiscal plan, incorporating revenue projections and spending plans, which combine to determine the resulting budgetary balance. The budget also introduces proposals for changes in taxation.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the Government together with the reasons underlying major variances.

Debt Management Strategy

This report is tabled annually in Parliament. It provides information on the federal government's debt management strategy for the coming fiscal year.

Debt Management Report

This annual document provides an accounting of the key elements of federal debt strategy and describes various strategic and operational aspects of the Government's debt program and cash management activities over the past fiscal year.

The Estimates

Each year the Government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board and consists of three parts:

Part I – The Government Expenditure Plan provides an overview of federal spending and summarizes the relationship of the key elements of the Main Estimates to the Expenditure Plan set out in the budget.

Part II – The Main Estimates directly support the Appropriations Act.

Part III – Departmental Expenditure Plans, which consist of two components – Reports on Plans and Priorities and Departmental Performance Reports.

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Annual Financial Report

of the Government of Canada

Fiscal Year 2003–2004

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Annual Financial Report

of the Government of Canada

Fiscal Year 2003–2004

The Government of Canada posted a budgetary surplus of $9.1 billion in 2003–04, marking the seventh consecutive year in which it has recorded a surplus—the first time this has occurred since Confederation.

Consistent with generally accepted accounting principles, the entire $9.1 billion has been applied to reduce the federal debt. The better-than-expected outcome is primarily due to much higher-than-expected budgetary revenues in the final quarter of the fiscal year, in part reflecting stronger-than-expected nominal income growth in that quarter. As well, the revenue yield—that is, the amount of tax revenue collected per dollar of income—was significantly higher than anticipated, particularly in light of the incremental tax reductions that came into effect as part of the Five-Year Tax Reduction Plan.

As a result of the budgetary surpluses recorded since 1997–98, the federal debt (accumulated deficit) has been reduced by $61.4 billion to $501.5 billion from its peak of $562.9 billion in 1996–97. Taking all levels of government together (federal, provincial and local governments and the Canada and Quebec Pension Plan), the Organisation for Economic Co-operation and Development estimates that Canada was the only Group of Seven (G-7) country to post a surplus in 2003.

Department of Finance Canada   Ministère des Finances Canada

Federal debt as a percentage of the economy was 41.1 per cent in 2003–04, a reduction of 27.3 percentage points from its peak of 68.4 per cent in 1995–96. On an international basis, for the total government sector Canada has made more progress in reducing its debt burden than any other G-7 country. From having the second highest debt burden in the mid-1990s, Canada's net debt burden was below the G-7 average and below those in the United States, France, Germany, Italy and Japan in 2003. The United Kingdom had a marginally lower debt burden than Canada in 2003.

The reduction in the federal debt burden is important for a variety of reasons. A lower debt burden, resulting from a reduction in interest-bearing debt, means that a smaller portion of the revenue the Government collects from taxpayers must go towards debt-servicing payments, thereby leaving more resources for reducing taxes and funding valued programs and services. The savings to the Canadian taxpayer from lower debt servicing costs stand at over $3 billion per year. A lower debt burden also lessens the exposure of Canada's fiscal situation to economic shocks, especially an increase in interest rates or a prolonged slowdown in economic activity. Sustained balanced budgets and putting the debt on a steady downward track have also restored Canada's Triple-A credit rating in financial markets. Since this effectively sets the standard for the whole country, everyone benefits—from provinces and municipalities to individuals wanting to buy a home, start a business or run a farm.

Simple fairness also demands that future generations not be saddled with a debt they did not incur. Right now, even after the progress we've made in eliminating the deficit and reducing debt, annual debt-servicing costs (at some $35 billion) are still the largest single expense of the Government of Canada. Unless we continue to reduce the debt burden, the inheritance we leave to our children and grandchildren will be a heavy mortgage on their futures.

We also have to begin to prepare now for an aging population. In Canada the real force of this demographic trend will hit when the baby boomers begin to retire around 2010—a little over six years from now. As the largest generation ever leaves the workforce, a much smaller one will be left to take its place. This will have at least two profound effects on our society: first, there will be greater demand for the social programs we value, particularly health care; and second, there will be fewer people working to support those programs. This again speaks to why it is so important to pay down debt, year after year. The less debt we carry, the more flexibility we have to meet emerging demographic pressures.

In the March 2004 budget, we set an objective of reducing Canada's debt-to-GDP (gross domestic product) ratio from about 41 per cent today to 25 per cent within 10 years. Achieving the 25-per-cent debt-to-GDP ratio will mean that less government revenue will have to go to pay interest on public debt and that billions of dollars more will be available to help make up for fewer Canadians in the workplace of the future.

Good fiscal management requires that the Government equip itself with the best possible economic and fiscal projections. To that end, I have launched a comprehensive review of how we do our economic and fiscal forecasting. Such a review was last done in 1994 and much has changed since then—including the elimination of the deficit, the Government's commitment to maintaining a balanced budget or better each year, and the shift to full accrual accounting for the presentation of the Government's financial statements. The time has again come to test our assumptions and make sure that we are still using best practices—benchmarking ourselves against the best in the world. The Government of Canada is grateful to Mr. Tim O'Neill, a distinguished private sector economist, for leading this important analysis. It is my hope that such a review could be completed in time for the next federal budget.

The financial data in this report are based on the audited results, which will appear in more detail in the *Public Accounts of Canada 2004,* scheduled for tabling in the House of Commons this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 2003 to March 31, 2004) and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* publication has been updated to incorporate the results for 2003–04 and historical revisions to the *National Economic and Financial Accounts* published by Statistics Canada. These tables are an integral part of this report.

The Honourable Ralph Goodale, P.C., M.P.
Minister of Finance

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Note to Readers

The figures contained in this report are presented on a net basis, consistent with the presentations in the budgets and in the Appropriation Acts, as approved by Parliament. In contrast, the figures in the *Public Accounts of Canada 2004* are presented on a gross basis. The differences in classification affect both budgetary revenues and program expenses by a corresponding amount and, as such, have no impact on the budgetary balance. The impact of these classification differences on budgetary revenues and program expenses is explained in this report.

The Government reports all revenues and expenses on an accrual basis. Further details on the Government's accounting policies can be found in the section entitled "Notes to the Condensed Financial Statements" and in the *Public Accounts of Canada 2004*.

Report Highlights

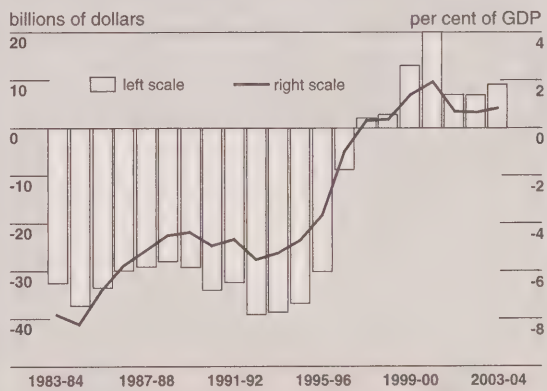
- On a full accrual basis of accounting, a budgetary surplus of $9.1 billion was achieved in 2003–04. This marks the seventh consecutive year the federal budget has been in surplus.
- Federal debt stood at $501.5 billion at the end of 2003–04, down $61.4 billion from its peak of $562.9 billion in 1996–97. The federal debt-to-GDP ratio is 41.1 per cent, down sharply from its peak of 68.4 per cent in 1995–96. It is at its lowest level since 1983–84.
- Market debt—the debt issued on credit markets—as a percentage of GDP has declined to 36.1 per cent from the peak of 58.2 per cent in 1995–96.
- The revenue-to-GDP ratio declined in 2003–04 to 15.3 per cent. While it has fallen by 1.7 percentage points since 2000–01, primarily reflecting the impact of the tax reductions announced in the February 2000 budget and October 2000 *Economic Statement and Budget Update*, it was little changed in 2003–04 notwithstanding the legislated decline in corporate and personal taxes.
- The program expenses-to-GDP ratio increased slightly to 11.6 per cent in 2003–04 from 11.5 per cent in 2002–03.
- Public debt charges declined by $1.5 billion in 2003–04. As a percentage of revenues, public debt charges were 19.2 per cent in 2003–04, down from its peak of about 39 per cent in 1990–91. It is now at its lowest level since the late 1970s.

The Budgetary Balance

A budgetary surplus of $9.1 billion was recorded in 2003–04, up $2.1 billion from the surplus of $7.0 billion in 2002–03. The increase in the surplus is primarily due to strong growth in nominal income—the applicable tax base for budgetary revenues—up 5.3 per cent, and a decline in public debt charges, reflecting the decline in short-term interest rates. Budgetary revenues increased by $8.4 billion, or 4.7 per cent, reflecting strong growth in corporate (up $5.2 billion or 23.4 per cent) and personal (up $3.2 billion or 3.9 per cent) income tax revenues. Public debt charges declined by $1.5 billion, or 4.0 per cent. Program expenses increased by $7.8 billion, or 5.8 per cent, primarily reflecting the impact of previous budget measures.

In the March 2004 budget, the Government estimated the budgetary surplus at $1.9 billion for 2003–04. This amount was allocated to the Contingency Reserve. This was after responding to a number of shocks that hit the economy in 2003—the bovine spongiform encephalopathy (BSE) crisis, the severe acute respiratory syndrome (SARS) outbreak, Hurricane Juan across Atlantic Canada, and forest fires in British Columbia. It was also after providing an additional $2.4 billion to the provinces and territories for health care. The better-than-expected outcome for 2003–04 compared to the March 2004 budget estimate is primarily attributable to much higher-than-expected budgetary revenues in the final quarter of the fiscal year, in part reflecting much stronger-than-expected income growth in the first quarter of 2004. In addition, the revenue yield—that is,

Budgetary Balance



Sources: *Public Accounts of Canada* and Statistics Canada.

the amount of tax revenue collected per dollar of income—was significantly higher than anticipated. A decline in the ratio had been expected, given the scheduled $4.5-billion tax decrease in 2003–04 as part of the $100-billion Five-Year Tax Reduction Plan.

Budgetary revenues were $5.1 billion higher, due primarily to stronger-than-expected growth in personal and corporate income tax revenues and in other revenues. Program expenses were $2.0 billion lower than expected, in part reflecting higher-than-expected lapses resulting from the year-end spending freeze and delays in implementing initiatives from previous budgets.

The budgetary surplus of $9.1 billion, or 0.7 per cent of GDP, in 2003–04 represents a substantial improvement from the deficit of $38.5 billion, or 5.3 per cent of GDP, in 1993–94. As a percentage of GDP, all of this fiscal improvement since 1993–94 is attributable to the decline in total expenses. Program expenses as a percentage of GDP declined from 15.7 per cent in 1993–94 to 11.6 per cent in 2003–04, while public debt charges fell from 5.5 per cent in 1993–94 to 2.9 per cent in 2003–04. In contrast, budgetary revenues fell from 16.0 per cent in 1993–94 to 15.3 per cent in 2003–04.

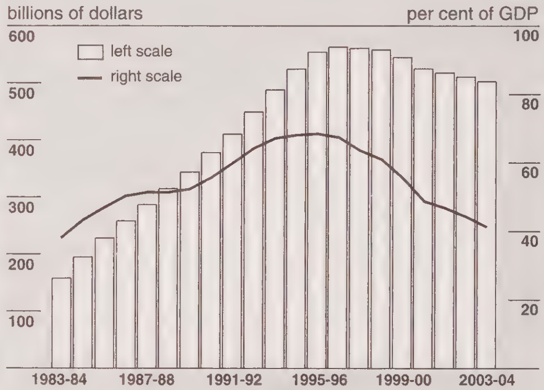
Sound financial management has been at the core of the Government's economic strategy over the past 10 years. This strategy has put an end to almost three decades of chronic deficits and replaced them with seven consecutive surpluses—an achievement unparalleled since Confederation. The commitment to sound financial management allowed Canada to post a total government sector budgetary surplus in 2003, while all other G-7 countries recorded deficits. It has brought Canada's total government sector debt-to-GDP ratio from the second highest in the G-7 in the mid-1990s to the second lowest level in 2003.

Since posting its first budgetary surplus in 1997–98, Canada has led the G-7 in job creation and real GDP growth. The Government's fiscal credibility allowed monetary policy to support the economy during the global slowdown in 2001 and to cope with a series of significant shocks that hit the Canadian economy in 2003.

Federal Debt

The 2003–04 surplus of $9.1 billion brings the federal debt—the accumulation of annual deficits and surpluses—down to $501.5 billion. From its peak of $562.9 billion in 1996–97, federal debt has declined by $61.4 billion. As a share of GDP, federal debt dropped to 41.1 per cent in 2003–04, down 27.3 percentage points from the peak of 68.4 per cent in 1995–96. This is the eighth consecutive year in which the federal debt-to-GDP ratio has declined, bringing it to its lowest level since 1983–84. Federal debt at the end of 2003–04 was $15,758 for each Canadian, down from $16,188 a year earlier and down from $18,876 at the end of 1996–97, the last year the federal government recorded a deficit.

Federal Debt (Accumulated Deficit)



Sources: *Public Accounts of Canada* and Statistics Canada.

Federal Debt (Accumulated Deficit)

Since 2002–03 the financial statements of the Government of Canada have been presented on a full accrual basis of accounting. Under the previous accounting standard—modified accrual accounting—net debt and the accumulated deficit were identical. Under the new standard, net debt now includes a comprehensive costing for financial liabilities but excludes non-financial assets. The accumulated deficit includes both. It is the sum of all surpluses and deficits in the past.

Federal debt, referred to in the budget documents and the *Annual Financial Report of the Government of Canada*, is the accumulated deficit. It is the federal government's main measure of debt, as annual changes in this measure determine the budgetary balance.

Table 1

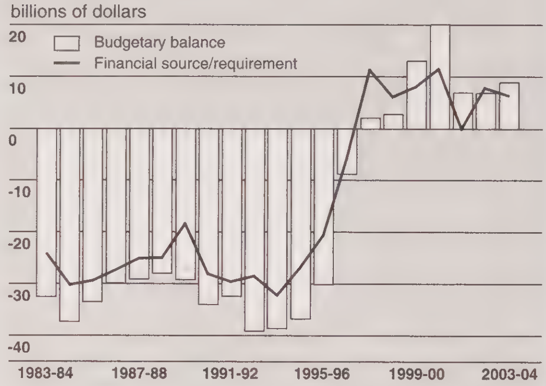
Financial Highlights

	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04
				($ billions)			
Budgetary transactions							
Revenues	152.1	156.1	166.1	182.7	171.7	177.8	186.2
Expenses							
Program expenses	-106.9	-110.0	-109.6	-118.7	-125.0	-133.6	-141.4
Public debt charges	-43.1	-43.3	-43.4	-43.9	-39.7	-37.3	-35.8
Total expenses	-150.0	-153.3	-153.0	-162.6	-164.7	-170.9	-177.1
Budgetary balance	**2.1**	**2.8**	**13.1**	**20.2**	**7.0**	**7.0**	**9.1**
Non-budgetary transactions	9.0	2.4	-5.3	-8.9	-7.4	0.6	-2.8
Financial source/requirement	11.1	5.2	7.9	11.3	-0.3	7.6	6.2
Net change in financing activities	-9.6	-6.2	-4.0	-10.0	-4.1	-2.5	-2.2
Net change in cash balances	1.5	-1.0	3.8	1.3	-4.4	5.1	4.1
Cash balance at end of period	11.7	10.7	14.5	15.8	11.4	16.5	20.5
Financial position							
Total liabilities	711.3	714.9	715.8	715.1	704.3	700.1	701.1
Total financial assets	103.3	108.3	120.9	138.8	133.4	135.3	144.8
Net debt	607.9	606.6	595.0	576.3	570.9	564.8	556.3
Non-financial assets	47.2	48.7	50.2	51.7	53.4	54.2	54.8
Federal debt (accumulated deficit)	**560.7**	**557.9**	**544.7**	**524.6**	**517.5**	**510.6**	**501.5**
Financial results (% of GDP)							
Budgetary revenues	17.2	17.1	16.9	17.0	15.5	15.4	15.3
Program expenses	12.1	12.0	11.2	11.0	11.3	11.5	11.6
Public debt charges	4.9	4.7	4.4	4.1	3.6	3.2	2.9
Budgetary balance	0.2	0.3	1.3	1.9	0.6	0.6	0.7
Federal debt (accumulated deficit)	63.5	61.0	55.4	48.7	46.7	44.1	41.1

Note: Numbers may not add due to rounding.

Federal debt consists of interest-bearing debt and other liabilities, net of financial and non-financial assets. Interest-bearing debt, in turn, consists of unmatured, or market, debt and the Government's obligations to internally held accounts—primarily the liabilities for the federal government employees' pension plans. All of the decrease in the federal debt of $9.1 billion in 2003–04 is attributable to an increase of $9.5 billion in financial assets—cash and accounts receivable and loans, investments and advances. Market debt declined by $2.2 billion while obligations to pension and other accounts increased by $2.6 billion. Both other liabilities and non-financial assets increased by $0.6 billion.

Budgetary Balance and Financial Source/Requirement



Sources: *Public Accounts of Canada* and Statistics Canada.

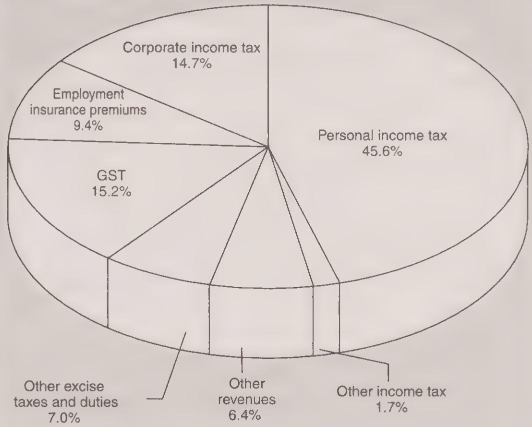
Financial Source/Requirement

The financial source/requirement measures the difference between cash coming in to the Government and cash going out. There was a financial source of $6.2 billion in 2003–04, compared to a financial source of $7.6 billion in 2002–03. This lower source is primarily attributable to higher cash requirements for investing activities, in part due to increased direct financing to students.

BUDGETARY REVENUES

Budgetary revenues were reported at $186.2 billion, an increase of $8.4 billion, or 4.7 per cent, from 2002–03. Nominal income—the applicable tax base for revenues—advanced by 5.3 per cent in 2003, up from the increase of 4.5 per cent in 2002. The net impact of stronger nominal income growth in 2003 on revenues was somewhat dampened by the incremental impact of the tax reductions introduced in previous budgets, especially the restoration of full indexation of the personal income tax system, increases in the Canada Child Tax Benefit (which are netted against personal income tax revenues) and reductions in the corporate income tax rate. However, the revenue yield, at 15.3 per cent, was significantly higher than expected, given the legislated tax reductions. Most of the increase in budgetary revenues resulted from higher personal and corporate income taxes.

Composition of Net Revenues for 2003–04



Source: *Public Accounts of Canada*.

Budgetary revenues were $5.1 billion higher than estimated in the March 2004 budget. The higher revenues are attributable to the

Table 2

Revenues

	2002–03	2003–04	Net change	
		($ millions)		(%)
Tax revenues				
Net income tax collections				
Personal income tax	81,707	84,895	3,188	3.9
Corporate income tax	22,222	27,431	5,209	23.4
Other income tax revenues	3,291	3,142	-149	-4.5
Total	107,220	115,468	8,248	7.7
Other taxes and duties				
Goods and services tax (GST)	28,248	28,286	38	0.1
Customs import duties	3,278	2,887	-391	-11.9
Energy taxes	4,935	4,952	17	0.3
Air Travellers Security Charge	421	410	-11	-2.6
Other excise taxes and duties	4,475	4,830	355	7.9
Total	41,357	41,365	8	0.0
Net tax revenues	**148,577**	**156,833**	**8,256**	**5.6**
Employment insurance premium revenues	17,870	17,546	-324	-1.8
Net other revenues				
Crown corporation revenues	3,748	4,719	971	25.9
Foreign exchange revenues	3,379	2,090	-1,289	-38.1
Other revenues	4,258	5,020	762	17.9
Total	11,385	11,828	443	3.9
Net budgetary revenues	**177,832**	**186,207**	**8,375**	**4.7**

Note: Numbers may not add due to rounding.

stronger-than-expected economic growth in the final quarter of the 2003–04 fiscal year and to a higher-than-estimated revenue yield. Notwithstanding a scheduled $4.5-billion tax decrease in 2003–04 as part of the $100-billion Five-Year Tax Reduction Plan, the revenue yield was roughly unchanged, whereas a decline had been expected. For example, corporate income tax revenues were up 23.4 per cent, significantly stronger than the 10.0-per-cent increase in corporate profits, despite a 2-percentage-point reduction in the general tax rate. Similarly, personal income tax revenues increased 3.9 per cent, stronger than the 3.0-per-cent increase in the applicable tax base, despite increases to the various thresholds and the Canada Child Tax Benefit.

Personal income tax revenues, the largest component at over 45 per cent of budgetary revenues, increased by $3.2 billion, or 3.9 per cent, in 2003–04. This is stronger than the growth of 3.0 per cent in personal income, which is somewhat surprising in light of the impact of the tax reduction measures introduced in previous budgets. As part of the $100-billion Five-Year Tax Reduction Plan, first announced in the February 2000 budget, tax rates were reduced, thresholds at which the tax rates are effective were increased, and the Canada Child Tax Benefit was enhanced. The impact of these measures was to reduce personal income tax revenues by an incremental $2.7 billion in 2003–04. The Canada Child Tax Benefit was also increased in the February 2003 budget.

Corporate income tax revenues increased by $5.2 billion, or 23.4 per cent, in 2003–04, following two consecutive years of decline. The increase in 2003–04 well exceeded the 10.0-per-cent growth in corporate profits. The much stronger growth in corporate income tax revenues compared to corporate profits is somewhat surprising, given the reduction in the federal tax rate from 25 per cent effective January 1, 2002 to 23 per cent effective January 1, 2003. In 2000 the tax rate was 28 per cent. The increase in corporate income tax revenues is in part attributable to the application of loss carry-forwards in 2002–03 due to the decline in profits in 2001, which reduced tax revenues in 2002–03, and strong growth in profits in the financial sector, in part reflecting valuation gains associated with the appreciation of the Canadian dollar.

Other taxes and duties were virtually unchanged from 2002–03, after recording a gain of $4.2 billion, or 11.4 per cent, in 2002–03.

- Goods and services tax (GST) revenues increased by $38 million, or 0.1 per cent, following a gain of $3.0 billion in 2002–03. Weakness in consumer expenditures, especially durable goods, and a decline in the Canadian-dollar value of imports, in part reflecting the appreciation of the Canadian dollar, restrained the growth in GST revenues in 2003–04. In addition, rebates were up, reflecting the March 2004 budget decision to provide a full rebate of GST and the federal portion of the harmonized sales tax (from 57.14 per cent to 100 per cent) paid by municipalities, effective February 1, 2004.
- Customs import duties declined $0.4 billion, or 11.9 per cent, primarily reflecting the impact of the appreciation in the value of the Canadian dollar.
- Energy taxes were virtually unchanged, while the impact of tobacco excise tax increases in 2002 accounted for most of the increase of $0.4 billion, or 7.9 per cent, in other excise taxes and duties. The Air Travellers Security Charge, which came into effect April 1, 2002, was down slightly, reflecting lower demand for air travel, in part due to the outbreak of SARS and the conflict in Iraq. The revenues from this charge are used to fund the new air security initiatives announced in the 2001 budget.

Employment insurance premium revenues declined $0.3 billion, or 1.8 per cent, as the reduction in premium rates more than offset the impact of the increase in the number of people employed and therefore paying premiums. The employee premium rate (per $100 of insurable earnings) was reduced from $2.20 for 2002 to $2.10 for 2003 and $1.98 for 2004 (with a corresponding decline in the employer rate).

Other revenues consist of net gains/losses from Crown corporations such as the Bank of Canada, Export Development Canada and Canada Mortgage and Housing Corporation; foreign exchange revenues; and other revenues, primarily from the sale of goods and services. Other revenues were up $0.4 billion, or 3.9 per cent, primarily reflecting higher profits from Crown corporations (up $1.0 billion) and other revenues (up $0.8 billion).

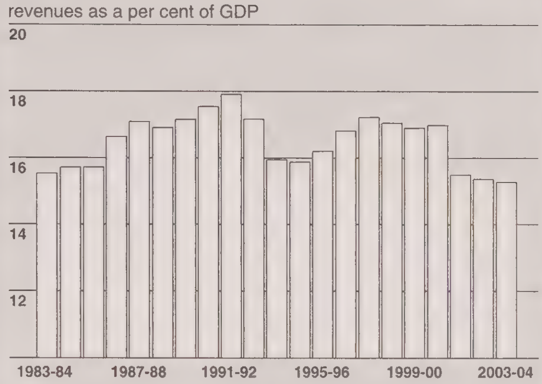
In contrast, foreign exchange revenues were down $1.3 billion due to the appreciation in the value of the Canadian dollar, as the assets in the Exchange Fund Account are denominated in foreign currencies.

The revenue ratio—budgetary revenues as a percentage of GDP—represents an approximate measure of the overall federal "tax burden" in that it compares the total of all federal revenues collected to the size of the economy. The revenue ratio stood at 15.3 per cent in 2003–04, down slightly from 2002–03. A significant decline had been expected, suggesting that the tax yield was higher than assumed at the time of the March 2004 budget.

It should be noted that some components of income subject to taxation are excluded from the Statistics Canada measure of GDP, such as capital gains and income from trusteed pension plans. As a result, this ratio overstates the effective tax burden. In addition, the nominal income estimates are subject to annual revision by Statistics Canada, which has resulted in changes in this ratio once revised data are incorporated. Therefore, caution should be exercised in interpreting this ratio.

The figures in Table 2 are presented on a "net" basis, reflecting the way in which revenues and expenses are presented to Parliament in the Government's annual budget. As a result, the Canada Child Tax Benefit is netted against personal income tax revenues. Departmental revenues that are levied for specific services, such as the contract costs of policing services in provinces, are netted against expenses, as such revenues are credited to the department in accordance with parliamentary authority. Expenses of consolidated Crown corporations in excess of their appropriations are netted against their total revenues. This classification has the effect of reducing both revenues and expenses but has no impact on the budgetary balance. Table 3 shows the impact of "grossing up" budgetary revenues for these adjustments. In 2003–04, they amounted to $12.3 billion, virtually unchanged from the previous fiscal year. The largest component is the Canada Child Tax Benefit, amounting to $8.1 billion in 2003–04, up 3.1 per cent from 2002–03. As a result, gross budgetary revenues were $198.5 billion in 2003–04, up 4.4 per cent from 2002–03.

Revenue Ratio



Sources: Department of Finance and Statistics Canada.

Table 3

Reconciliation Between Net and Gross Budgetary Revenues

	2002–03	2003–04	Net change	
		($ millions)		(%)
Net budgetary revenues	**177,832**	**186,207**	**8,375**	**4.7**
Adjustments				
Canada Child Tax Benefit	7,823	8,062	239	3.1
Revenues netted against program expenses	3,020	3,076	56	1.9
Expenses of consolidated Crown corporations	1,557	1,201	-356	-22.8
Net adjustment	12,400	12,340	-60	-0.5
Gross budgetary revenues	**190,232**	**198,547**	**8,315**	**4.4**

Note: Numbers may not add due to rounding.

Total Expenses

Total expenses consist of two components—public debt charges and program expenses. In 2003–04 total expenses amounted to $177.1 billion, up $6.3 billion, or 3.7 per cent, from 2002–03 (see Table 4). Public debt charges declined by $1.5 billion, or 4.0 per cent, while program expenses advanced $7.8 billion, or 5.8 per cent. Program expenses were $2.0 billion lower than estimated in the 2004 budget. This underestimation is considerably lower than in each of the two previous fiscal years.

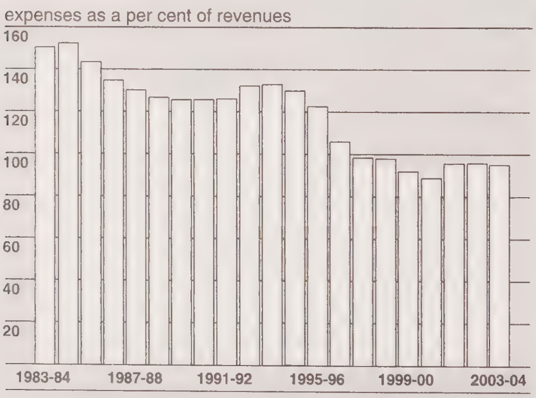
The expense ratio—total expenses as a percentage of budgetary revenues—stood at 95.1 per cent in 2003–04, down a full percentage point from 2002–03. In 1993–94 the expense ratio stood at 133.2 per cent. This meant that revenues were insufficient to cover total expenses and the Government incurred a deficit.

Public debt charges declined by $1.5 billion, or 4.0 per cent, to $35.8 billion in 2003–04, primarily attributable to a decline in the average effective interest rates on interest-bearing debt.

- The average effective interest rate on the Government's interest-bearing debt (unmatured debt and pension liabilities) was 5.8 per cent in 2003–04, compared to 6.0 per cent in 2002–03. The average effective interest rate was 5.3 per cent on unmatured debt, compared to 5.7 per cent in 2002–03. In contrast, the average effective interest rate was 6.8 per cent on pension and other accounts, unchanged from 2002–03.
- The stock of total interest-bearing debt increased by $0.4 billion, from $620.7 billion in 2002–03 to $621.1 billion in 2003–04. The stock of market debt declined by $2.2 billion to $440.2 billion, while liabilities to pension and other accounts increased by $2.6 billion to $180.9 billion.

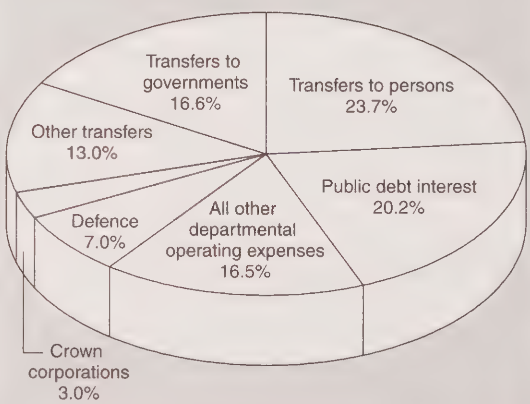
The interest ratio—public debt charges as a percentage of budgetary revenues—declined from 21.0 per cent in 2002–03 to 19.2 per cent in 2003–04. This ratio means that, in 2003–04, the Government spent just over 19 cents of every revenue dollar on interest on the public debt. This is down from the peak of about 39 cents in 1990–91 and is the lowest this ratio has been since the late 1970s. This is money that must be paid to meet the Government's ongoing obligations on its debt. The lower the ratio, the more flexibility the Government has to address the key priorities of Canadians.

Expense Ratio



Source: Department of Finance.

Composition of Net Expenses for 2003–04



Source: *Public Accounts of Canada.*

Table 4
Total Expenses

	2002–03	2003–04	Net change	
		($ millions)		(%)
Transfers payments				
Major transfers to persons				
Elderly benefits	25,692	26,902	1,210	4.7
Employment insurance benefits	14,496	15,058	562	3.9
Total	40,188	41,960	1,772	4.4
Major transfers to other levels of government				
Canada Health and Social Transfer	18,600	20,341	1,741	9.4
Canada Health and Social Transfer supplement	2,500	2,000	-500	
Diagnostic/Medical Equipment Fund	1,500		-1,500	
National Immunization Fund		400	400	
Fiscal arrangements	10,366	9,351	-1,015	-9.8
Alternative Payments for Standing Programs	-2,321	-2,700	-379	16.3
Total	30,645	29,392	-1,253	-4.1
Subsidies and other transfers[1]	19,987	22,964	2,977	14.9
Total transfer payments	90,820	94,316	3,496	3.8
Other program expenses				
Crown corporations				
Canada Mortgage and Housing Corporation	1,979	2,092	113	5.7
Canadian Broadcasting Corporation	1,047	1,066	19	1.8
Other cultural agencies	481	539	58	12.1
Canadian Air Transport Security Authority	259	351	92	35.4
Other	1,228	1,316	88	7.2
Total	4,994	5,365	371	7.4
Defence	11,332	12,449	1,117	9.9
All other departments and agencies	26,447	29,225	2,778	10.5
Total other program expenses	42,773	47,039	4,266	10.0
Net program expenses	**133,593**	**141,355**	**7,762**	**5.8**
Public debt charges	37,270	35,769	-1,501	-4.0
Net expenses	**170,863**	**177,124**	**6,261**	**3.7**

[1] See Table 5 for details.

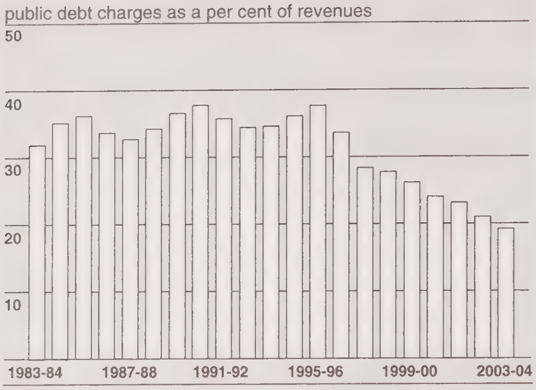
Note: Numbers may not add due to rounding.

Program expenses amounted to $141.4 billion in 2003–04, an increase of $7.8 billion, or 5.8 per cent, from 2002–03. Increases were recorded in all major components with the exception of major transfers to other levels of government. The decline in this component is attributable to the inclusion of larger one-time payments to provinces and territories for health care in 2002–03 than in 2003–04 and lower equalization entitlements due to prior-year adjustments. The increases in the other components primarily reflect the impact of previous budget measures as well as one-time adjustments that lowered expenses in 2002–03.

Major transfer payments to persons increased by $1.8 billion, or 4.4 per cent.

- Elderly benefits consist of Old Age Security, Guaranteed Income Supplement and Allowance payments. Total benefits were up $1.2 billion, or 4.7 per cent, in 2003–04, reflecting both higher average benefits, which are indexed to inflation, and an increase in the number of recipients.

Interest Ratio



Source: Department of Finance.

- Employment insurance benefits consist of regular benefits, special benefits (sickness, maternity, paternity, adoption and fishing) and labour market adjustment benefits. Total benefits increased by $0.6 billion in 2003–04, reflecting both an increase in the number of beneficiaries and an increase in average weekly benefits. The increase in benefit payments was about equally split between regular benefit payments and special benefits, in particular the increase in parental benefits.

Major transfer payments to other levels of government include the Canada Health and Social Transfer (CHST), fiscal arrangements (equalization, transfers to the territories, as well as a number of smaller transfer programs) and Alternative Payments for Standing Programs. Transfers declined by $1.3 billion, or 4.1 per cent, in 2003–04, following an increase of $4.0 billion in 2002–03, or 15.1 per cent. This decline is attributable to lower one-time special transfers for health care and lower equalization entitlements due to prior-year adjustments.

- The CHST—a block-funded transfer—supports health care, post-secondary education, social assistance and social services, including early childhood development. It provides support in the form of cash and tax transfers to the provinces and territories. As part of the September 2000 and February 2003 health accords, the federal government legislated an incremental $1.7 billion to be paid in 2003–04. However, one-time transfers in 2003–04 were less than in 2002–03. In 2002–03, an incremental $2.5 billion was transferred in the form of a special supplement and an additional $1.5-billion investment was provided to the Diagnostic/Medical Equipment Fund to be used by the provinces and territories in support of specialized staff training and equipment, to improve access to publicly funded diagnostic services. In 2003–04, an incremental $2.0 billion was transferred in the form of a special supplement and $0.4 billion to support a national immunization strategy and to assist provinces and territories in enhancing their public health capacities.
- Total entitlements under fiscal arrangements decreased by $1.0 billion to $9.4 billion, primarily reflecting lower equalization entitlements. Under the equalization program, the federal government transfers funds to the less prosperous provinces so that they can provide their residents with public services reasonably comparable to those in other provinces without having to resort to higher-than-average taxation. The decline in equalization entitlements reflects stronger-than-expected economic growth in 2002 in the equalization-receiving provinces relative to the non-equalization-receiving provinces and, hence, a convergence in the estimated provincial fiscal capacity of the equalization-receiving provinces relative to the equalization standard. This has been carried forward into 2003–04. The decline in 2003–04 is primarily attributable to the recording of a receivable for recoveries related to the overpayments in 2002–03.
- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allow provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provides provinces with tax points, the value of which are netted against total entitlements and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Subsidies and other transfers advanced by $3.0 billion, or 14.9 per cent (see Table 5). About half of this increase ($1.4 billion) is attributable to special assistance to the Canadian cattle industry following the discovery in May 2003 of a case of BSE and the resulting closure of export markets to Canadian beef and cattle. An additional $330 million was provided to the province of Ontario in recognition of its extraordinary effort to protect public health during the SARS outbreak. Most of the remaining increase in this component is attributable to previous budget measures. These include a commitment to increase Canada's international assistance by 8 per cent per year; the establishment of the Primary Health Care Transition Fund as part of the September 2000 health accord; increased assistance to students; increased funding to the granting councils (Canadian Institutes of Health Research, Natural Sciences and Engineering Research Council [NSERC] and Social Sciences and Humanities Research Council [SSHRC]); and endowments of $250 million to Sustainable Development Technology Canada and $85 million to the Canadian Council on Learning.

Table 5
Subsidies and Other Transfers

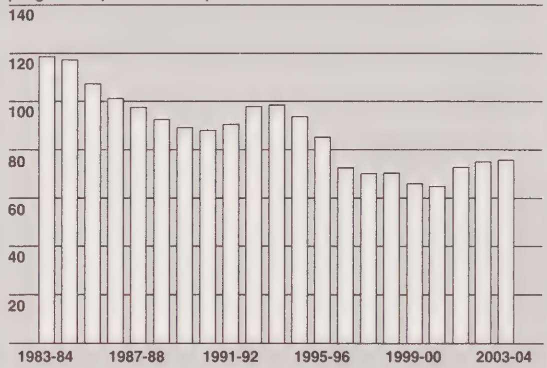
	2002–03	2003–04	Net change	
		($ millions)		(%)
Agriculture and Agri-Food				
BSE recovery program		1,401	1,401	
Other	2,654	2,519	-135	-5.1
Foreign Affairs and International Trade	2,456	2,683	227	9.3
Health Canada				
First Nations and Inuit health	678	702	24	3.6
Canadian Institutes of Health Research	587	647	60	10.2
Primary Health Care Transition Fund	48	209	161	334.2
Grant to Ontario: SARS		330	330	
Other	401	576	175	43.5
Human Resources Development				
Student assistance programs	582	804	223	38.2
Labour market programs	716	735	20	2.8
Canadian Council on Learning		85	85	
Other	304	407	103	33.7
Indian Affairs and Northern Development	4,649	4,794	145	3.1
Industry/regional agencies/granting councils				
Technology Partnerships Canada	328	312	-16	-4.9
Infrastructure Canada	253	334	82	32.3
Regional agencies	667	761	95	14.2
NSERC/SSHRC	784	1,134	350	44.7
Other	417	492	75	18.0
Canada Foundation for Innovation	500		-500	
Canada Health Infoway	600	100	-500	-83.3
Genome Canada	75		-75	
Sustainable Development Technology Canada		250	250	
Other	3,290	3,687	398	12.1
Total	**19,987**	**22,964**	**2,977**	**14.9**

Note: Numbers may not add due to rounding.

Other program expenses—total program expenses less transfers—consist of expenses related to Crown corporations, and operating expenses of departments and agencies, including National Defence. These expenses amounted to $47.0 billion in 2003–04, up $4.3 billion, or 10.0 per cent, from 2002–03. Part of this increase is attributable to special adjustments which lowered expenses in 2002–03 and were not repeated in 2003–04. Within this component:

- Expenses related to Crown corporations increased $0.4 billion to $5.4 billion in 2003–04. This component includes appropriations to consolidated Crown corporations (those Crown corporations that rely on government funding as their principal source of revenue).
- Defence expenses increased $1.1 billion, or 9.9 per cent, primarily reflecting incremental funding of $800 million provided in the 2003 budget to strengthen Canada's military. Incremental funding was also provided for mission costs to support Canada's international commitments.
- All other departmental and agency expenses increased by $2.8 billion, or 10.5 per cent, following a slight decline in 2002–03 due to downward adjustments to allowances for loans and other liabilities.

Program Share



Source: Department of Finance.

The program share—program expenses as a percentage of budgetary revenues—amounted to 75.9 per cent in 2003–04, up slightly from 75.1 per cent in 2002–03. In 1993–94 the program share was 98.6 per cent.

The above numbers are presented on a "net" basis, as discussed in the previous section, "Budgetary Revenues." Gross expenses are $12.3 billion higher than net expenses, as shown in Table 6.

Table 6
Reconciliation Between Net and Gross Expenses

	2002–03	2003–04	Net change	
		($ millions)		(%)
Net expenses	**170,863**	**177,124**	**6,261**	**3.7**
Adjustments				
Canada Child Tax Benefit	7,823	8,062	239	3.1
Revenues netted against program expenses	3,020	3,076	56	1.9
Expenses of consolidated Crown corporations	1,557	1,201	-356	-22.8
Net adjustment	12,400	12,340	-60	-0.5
Gross expenses	**183,263**	**189,464**	**6,201**	**3.4**

Note: Numbers may not add due to rounding.

The Budgetary Balance, Financial Source/Requirement and Debt

The budgetary balance is the most comprehensive measure of the federal government's fiscal results. It is presented on a full accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made, and recording tax revenues when earned, regardless of when the cash is received.

In contrast, the financial source/requirement measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance in that it includes cash transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, foreign exchange activities, and changes in other financial assets, liabilities and non-financial assets. These activities are included as part of non-budgetary transactions. The conversion from full accrual to cash accounting is also reflected in non-budgetary transactions.

As shown in Table 7, non-budgetary transactions in 2003–04 resulted in a net requirement of funds amounting to $2.8 billion, compared to a source of $0.6 billion in 2002–03. This decline reflects increased requirements for other investing activities, primarily for increased borrowings related to the Canada Student Loans Program, and for accounts payable, receivable, accruals and allowances.

With a budgetary surplus of $9.1 billion and a net requirement from non-budgetary transactions of $2.8 billion, there was a financial source of $6.2 billion in 2003–04, compared to a source of $7.6 billion in 2002–03.

With this financial source, the Government retired $2.2 billion of its market debt and increased its cash balances by $4.1 billion. Cash balances at March 31, 2004, stood at $20.5 billion.

Total liabilities consist of interest-bearing debt and other liabilities. Interest-bearing debt includes market debt and liabilities for pension and other accounts. At March 31, 2004, interest-bearing debt amounted to $621.1 billion, up $0.4 billion from a year earlier (see Table 8). Other liabilities, which include accounts payable and accrued liabilities, amounted to $80.0 billion, up $0.6 billion from 2002–03. As a result, total liabilities at March 31, 2004, stood at $701.1 billion, up $1 billion from the previous year.

Financial assets consist of cash and accounts receivable, including tax receivables, foreign exchange accounts and loans, investments and advances. Financial assets totalled $144.8 billion at March 31, 2004, up $9.5 billion from March 31, 2003. Increases were recorded in cash and accounts receivable (up $8.3 billion) and in loans, investments and advances (up $5.8 billion), while net assets in foreign exchange accounts declined by $4.6 billion. The latter primarily reflects a decline in foreign currency borrowings. As a result, net debt stood at $556.3 billion at March 31, 2004, down $8.5 billion from March 31, 2003, and $52.7 billion below the peak of $609 billion at March 31, 1997. As a per cent of GDP, net debt dropped to 45.6 per cent in 2003–04, down 28.2 percentage points from its peak of 73.9 per cent in 1995–96. This is the eighth consecutive year in which the net debt-to-GDP ratio has declined.

Non-financial assets, consisting of tangible capital assets, inventories and prepaid expenses, amounted to $54.8 billion at March 31, 2004, up $0.6 billion from March 31, 2003.

Table 7

Budgetary Balance, Financial Source/Requirement and Net Financing Activities

	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04
				($ billions)			
Surplus for the year	**2.1**	**2.8**	**13.1**	**20.2**	**7.0**	**7.0**	**9.1**
Non-budgetary transactions							
Pensions and other accounts							
Public sector pensions (net)	3.3	5.0	5.9	0.8	-2.3	-1.2	1.9
Canada Pension Plan	0.5	1.2	0.8	0.2	0.4	0.3	0.4
Other	0.9	1.1	0.8	2.2	0.9	1.2	0.4
Total	4.6	7.3	7.6	3.2	-1.0	0.3	2.6
Capital investing activities	-3.3	-3.7	-3.8	-3.8	-4.4	-4.8	-4.4
Other investing activities	2.8	3.4	3.1	0.4	1.5	0.5	-2.4
Other activities							
Accounts payable, receivable, accruals and allowances	4.7	-1.1	-7.6	-2.3	-4.2	-1.9	-6.8
Foreign exchange activities	-2.2	-5.7	-6.8	-8.8	-1.8	3.1	4.6
Amortization of tangible capital assets	2.3	2.3	2.3	2.3	2.6	3.3	3.5
Total other activities	4.9	-4.5	-12.2	-8.8	-3.4	4.6	1.4
Total non-budgetary transactions	9.0	2.4	-5.3	-8.9	-7.4	0.6	-2.8
Financial source/requirement	**11.1**	**5.2**	**7.9**	**11.3**	**-0.3**	**7.6**	**6.2**
Net change in financing activities							
Marketable bonds	15.8	9.6	-0.9	1.0	-1.1	-5.6	-9.5
Treasury bills	-23.1	-15.4	2.9	-11.2	5.5	10.4	9.0
Canada Savings Bonds	-2.7	-2.1	-1.2	-0.4	-2.3	-1.4	-1.3
Other	0.4	1.7	-4.9	0.5	-6.2	-5.9	-0.4
Total	-9.6	-6.2	-4.0	-10.0	-4.1	-2.5	-2.2
Change in cash balances	1.5	-1.0	3.8	1.3	-4.4	5.1	4.1
Cash at end of year	**11.7**	**10.7**	**14.5**	**15.8**	**11.4**	**16.5**	**20.5**

Note: Numbers may not add due to rounding.

With total liabilities of $701.1 billion, financial assets of $144.8 billion and non-financial assets of $54.8 billion, the federal debt (accumulated deficit) stood at $501.5 billion at March 31, 2004, down a total of $9.1 billion from 2002–03 and $61.4 billion from its peak in 1996–97. All of the decline in federal debt between 2002–03 and 2003–04 is attributable to the increase in financial assets.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $60.0 billion at the end of March 2004, representing 13.6 per cent of the Government's total market debt.

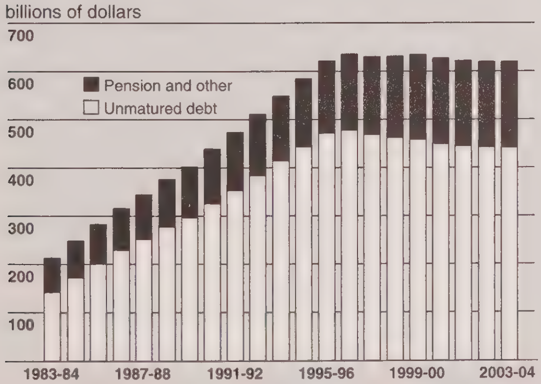
Table 8

Outstanding Debt at Year-End

	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04
				($ billions)			
Liabilities							
Accounts payable and accrued liabilities	81.2	83.7	81.1	87.2	81.5	79.4	80.0
Interest-bearing debt							
Unmatured debt	469.2	463.0	459.0	449.0	444.9	442.4	440.2
Pension and other accounts	160.9	168.2	175.8	179.0	177.9	178.3	180.9
Total	630.1	631.2	634.8	628.0	622.8	620.7	621.1
Total liabilities	711.3	714.9	715.8	715.1	704.3	700.1	701.1
Financial assets							
Cash and accounts receivable	55.2	55.9	61.0	67.0	59.8	62.6	70.9
Foreign exchange accounts	29.0	34.7	41.5	50.3	52.0	49.0	44.3
Loans, investments and advances	19.2	17.8	18.4	21.6	21.6	23.7	29.5
Total financial assets	103.3	108.3	120.9	138.8	133.4	135.3	144.8
Net debt	**607.9**	**606.6**	**595.0**	**576.3**	**570.9**	**564.8**	**556.3**
Non-financial assets							
Tangible capital assets	40.2	41.5	42.9	44.2	45.7	47.0	47.7
Inventories	6.2	6.3	6.5	6.6	6.4	6.1	6.1
Prepaid expenses	0.9	0.9	0.9	0.9	1.2	1.1	0.9
Total non-financial assets	47.2	48.7	50.2	51.7	53.4	54.2	54.8
Federal debt (accumulated deficit)	**560.7**	**557.9**	**544.7**	**524.6**	**517.5**	**510.6**	**501.5**

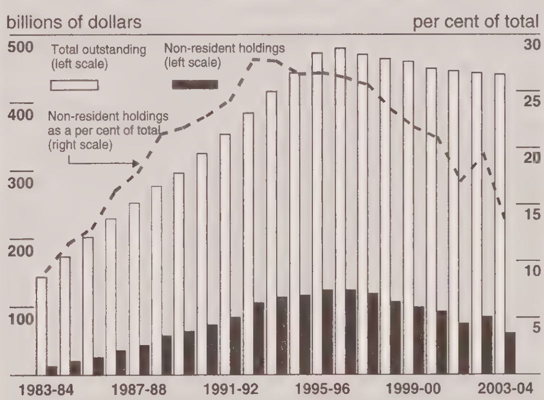
Note: Numbers may not add due to rounding.

Interest-Bearing Debt



Source: *Public Accounts of Canada.*

Foreign Holdings of Government of Canada Market Debt



Source: Bank of Canada.

Comparison of Actual Budgetary Outcomes to Budget Estimates

This section compares the actual outcome for the major components of the budgetary balance for 2003–04 to the estimates presented in the March 2004 budget. The Government targeted a balanced budget or better for 2003–04 in the March 2004 budget. Under the Debt Repayment Plan, the fiscal target for each year is based on:

- Using the average of private sector economic forecasts for budget-planning purposes.
- Including an annual Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. It is not a source of funding for new policy initiatives. If not needed, it is used to reduce the federal debt.
- Adding an extra degree of economic prudence to provide further assurance against falling back into deficit. As is normal practice, no additional prudence was added in the March 2004 budget for 2003–04, given that the fiscal year was nearly over.

After accounting for the fiscal impact of the new spending initiatives, the March 2004 budget estimated a surplus of $1.9 billion for 2003–04. This amount was allocated to the Contingency Reserve. The final audited budgetary surplus for 2003–04 was $9.1 billion.

Most of this improvement is attributable to higher budgetary revenues, up $5.1 billion from that estimated in the March 2004 budget. The higher revenues primarily relate to stronger-than-expected economic performance in the final quarter of the 2003–04 fiscal year and a higher-than-estimated tax yield from that expected at the time of the March 2004 budget.

Information received after the March 2004 budget indicated that tax liabilities with respect to the 2003 taxation year were higher than expected and that income growth in the final quarter of 2003–04 was stronger than forecast at the time of the March 2004 budget. Personal income tax revenues were $1.4 billion higher, attributable to higher-than-expected taxes paid on filing in April 2004 with respect to the 2003 taxation year. Corporate income tax revenues were $1.5 billion higher, reflecting higher settlement payments with respect to the 2003 taxation year. Corporations with a December 31 taxation year-end have 60 days to remit any taxes owing with respect to the taxation year. The stronger growth in corporate income tax revenues (up 23.4 per cent over the previous year) was surprising, given the growth in corporate profits in 2003 (up 10 per cent) and the 2-percentage-point reduction in the corporate tax rate in 2003. Excise taxes and duties were up $0.6 billion, primarily attributable to stronger GST receipts at year-end. Employment insurance premium revenues were up $0.4 billion, reflecting stronger employment gains in the final quarter of 2003–04. Higher net gains from Crown corporations explain most of the $1.3-billion increase in other revenues. The final outcome for 2003–04 indicates that the revenue yield was higher than expected at the time of the March 2004 budget, and this should carry forward into future years.

Program expenses were $2.0 billion lower than estimated in the March 2004 budget. This is considerably lower than the differences reported in each of the previous two fiscal years. Employment insurance benefits were $0.4 billion lower than expected, reflecting stronger employment gains in the final quarter of 2003–04, while elderly benefits were $0.1 billion lower. Major transfers to other levels of government were $0.3 billion higher than expected due to a lower estimated value of receivables relating to the equalization recoveries. The lower outcome for direct program expenses primarily relates to higher-than-expected lapses, in part due to the year-end freeze on discretionary spending and delays in implementing some of the previous budget initiatives.

Public debt charges were unchanged.

Table 9
Comparison of Actual Outcomes to March 2004 Budget

	Actual	2004 budget	Difference
		($ billions)	
Budgetary revenues			
Personal income tax	84.9	83.5	1.4
Corporate income tax	27.4	25.9	1.5
Other income tax	3.1	3.3	-0.1
Excise taxes and duties	41.4	40.8	0.6
Employment insurance premium revenues	17.5	17.1	0.4
Other revenues	11.8	10.5	1.3
Total	186.2	181.1	5.1
Program expenses			
Major transfers to persons			
Elderly benefits	26.9	27.0	-0.1
Employment insurance benefits	15.1	15.5	-0.4
Major transfers to other levels of government			
Canada Health and Social Transfer	22.7	22.7	0.0
Fiscal arrangements	9.4	8.7	0.6
Alternative Payments for Standing Programs	-2.7	-2.4	-0.3
All other expenses			
Subsidies and other transfers	23.0	23.8	-0.8
Crown corporations	5.4	5.5	-0.1
Defence	12.4	12.9	-0.4
Other departmental and agencies	29.2	29.7	-0.5
Total	141.4	143.4	-2.0
Public debt charges	35.8	35.8	0.0
Budgetary outcome/estimate	**9.1**	**1.9**	**7.2**

Note: Numbers may not add due to rounding.

Auditor General of Canada
Vérificatrice générale du Canada

Report of the Auditor General on the Condensed Financial Statements of the Government of Canada

To the Minister of Finance:

The accompanying condensed statements of operations and accumulated deficit, financial position, change in net debt and cash flow are derived from the complete financial statements of the Government of Canada as at March 31, 2004, and for the year then ended on which I expressed an opinion without reservation in my Report to the House of Commons dated September 7, 2004.

My Report drew two matters I have raised before to Parliament's attention: a concern about the Employment Insurance Account, and the recording of transfers to Foundations. For more complete information, readers should refer to my Report, which will be included in Volume I of the *Public Accounts of Canada 2004,* expected to be tabled in the House of Commons later this year.

The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility, in accordance with the applicable Assurance Guideline of The Canadian Institute of Chartered Accountants, is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria described in the Guideline referred to above.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and cash flow, reference should be made to the related complete financial statements, which will also be included in Volume I of the *Public Accounts of Canada 2004.*

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
September 7, 2004

Condensed Financial Statements of the Government of Canada

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs and resources for which the Government is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the Government.

These financial statements are extracted and condensed from the audited financial statements included in Section 2 of Volume I of the *Public Accounts of Canada 2004*, which are expected to be tabled in Parliament later this year. As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 10

Government of Canada
Condensed Statement of Operations and Accumulated Deficit for the Year Ended March 31, 2004

	2004		2003
	Budget[1]	Actual	Actual
		($ millions)	
Revenues			
Income tax	122,100	123,530	115,043
Other taxes and duties	43,100	41,365	41,357
Employment insurance premiums	17,600	17,546	17,870
Other revenues	14,500	16,106	15,962
Total revenues	***197,300***	***198,547***	***190,232***
Expenses			
Transfer payments			
Old age security and related payments	26,800	26,902	25,692
Other levels of government	31,000	29,392	30,645
Employment insurance benefits	15,700	15,058	14,496
Other transfer payments	30,100	31,026	27,810
Total transfer payments	*103,600*	*102,378*	*98,643*
Other program expenses	52,100	51,317	47,350
Total program expenses	***155,700***	***153,695***	***145,993***
Interest on debt	37,600	35,769	37,270
Total expenses	***193,300***	***189,464***	***183,263***
Annual surplus	**4,000**[2]	**9,083**	**6,969**
Accumulated deficit, beginning of year	510,600[3]	510,576	517,545
Accumulated deficit, end of year	**506,600**	**501,493**	**510,576**

[1] Derived from Budget 2003 and adjusted to a gross basis.

[2] Budget 2003 disclosed the budgetary surplus as $4 billion before deducting reserves for contingency ($3 billion) and economic prudence ($1 billion).

[3] Adjusted to the actual closing amount of previous year.

Table 11

Government of Canada
Condensed Statement of Financial Position as at March 31, 2004

	2004	2003
	($ millions)	
Liabilities		
Accounts payable and accrued liabilities	79,964	79,437
Interest-bearing debt		
Unmatured debt	440,231	442,416
Pension and other liabilities	180,898	178,287
Total interest-bearing debt	*621,129*	*620,703*
Total liabilities	***701,093***	***700,140***
Financial assets		
Cash and accounts receivable	70,921	62,626
Foreign exchange accounts	44,313	48,950
Loans, investments and advances	29,548	23,748
Total financial assets	***144,782***	***135,324***
Net debt	***556,311***	***564,816***
Non-financial assets		
Tangible capital assets	47,745	47,034
Other	7,073	7,206
Total non-financial assets	***54,818***	***54,240***
Accumulated deficit	**501,493**	**510,576**

Table 12

Government of Canada
Condensed Statement of Change in Net Debt
for the Year Ended March 31, 2004

	2004		2003
	Budget[1]	Actual	Actual
		($ millions)	
Net debt, beginning of year	**564,800**[2]	**564,816**	**570,907**
Change in net debt during the year			
Annual surplus	(4,000)[3]	(9,083)	(6,969)
Acquisition of tangible capital assets	4,700	4,535	5,051
Amortization of tangible capital assets	(3,100)	(3,502)	(3,341)
Other		(455)	(832)
Net decrease in net debt	(2,400)	(8,505)	(6,091)
Net debt, end of year	**562,400**	**556,311**	**564,816**

[1] Derived from Budget 2003.

[2] Adjusted to the actual closing amount of previous year.

[3] Budget 2003 disclosed the budgetary surplus as $4 billion before deducting reserves for contingency ($3 billion) and economic prudence ($1 billion).

Table 13

Government of Canada
Condensed Statement of Cash Flow
for the Year Ended March 31, 2004

	2004	2003
	($ millions)	
Cash provided by operating activities		
Annual surplus	9,083	6,969
Items not affecting cash	4,031	4,897
	13,114	**11,866**
Cash used for capital investment activities	**(4,444)**	**(4,763)**
Cash provided by (used for) investing activities	**(2,425)**	**498**
Total cash generated	***6,245***	***7,601***
Cash used to repay unmatured debt	**(2,185)**	**(2,475)**
Net increase in cash	**4,060**	**5,126**
Cash at beginning of year	16,486	11,360
Cash at end of year	**20,546**	**16,486**

Notes to the Condensed Financial Statements

1. Significant Accounting Policies

The Government of Canada reporting entity includes all departments, agencies, corporations and funds which are owned or controlled by the Government and which are accountable to Parliament. The financial activities of all these entities are consolidated in these statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the Government for financing their activities. These corporations are reported under the modified equity basis of accounting. The Canada Pension Plan is excluded from the reporting entity as it is under the joint control of the Government and participating provinces.

The Government accounts for transactions on an accrual basis. Financial assets recorded on the Condensed Statement of Financial Position can provide resources to discharge liabilities or finance future operations and are recorded at the lower of cost or net realizable value. Non-financial assets cannot normally be converted into cash to finance future operations without disrupting government operations; they are recorded at cost less accumulated amortization. Liabilities are recorded at the estimated amount ultimately payable, with pension and other similar benefits being determined on an actuarial basis. Valuation allowances are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the Government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable.

Comparative figures for 2003 have been reclassified to conform to the current year's presentation.

2. Contractual Commitments

Contractual commitments that will materially affect the level of future expenses include transfer payment agreements, acquisitions of goods and services, operating leases and funding of international organizations. At March 31, 2004, contractual commitments amounted to approximately $56 billion ($57 billion in 2003).

3. Contingent Liabilities

Guarantees by the Government amount to $71 billion ($75 billion in 2003) net of any recorded allowance. In addition, there are a number of contaminated sites where the Government could be obligated to incur costs. There are thousands of claims and pending and threatened litigation cases against the Government; the total amount claimed in these instances is significant but the final outcome is not determinable. Where cases are likely to be lost and an estimate of loss can be made, an amount is recorded in the financial statements. Insurance in force relating to self-sustaining insurance programs operated by three enterprise Crown corporations amounted to approximately $688 billion ($646 billion in 2003). The Government expects that it will not incur any costs to cover insurance claims under these programs.

Other Sources of Information

Public Accounts of Canada

The *Public Accounts of Canada*, as required under section 64(1) of the Financial Administration Act, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in three volumes:

- Volume I contains the Government's audited financial statements and supporting schedules and information;
- Volume II contains details of financial operations by ministry; and
- Volume III contains additional information and analyses.

Budget

The budget, usually introduced in February, presents the Government's overall fiscal plan, incorporating revenue projections and spending plans, which combine to determine the resulting budgetary balance. The budget also introduces proposals for changes in taxation.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the Government together with the reasons underlying major variances.

Debt Management Strategy

This report is tabled annually in Parliament. It provides information on the federal government's debt management strategy for the coming fiscal year.

Debt Management Report

This annual document provides an accounting of the key elements of federal debt strategy and describes various strategic and operational aspects of the Government's debt program and cash management activities over the past fiscal year.

Estimates

Each year the Government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board and consist of three parts:

Part I – The Government Expenditure Plan provides an overview of federal spending and summarizes the relationship of the key elements of the Main Estimates to the Expenditure Plan set out in the budget.

Part II – The Main Estimates directly support the Appropriations Act.

Part III – Departmental Expenditure Plans, which consist of two components—Reports on Plans and Priorities and Departmental Performance Reports.

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Annual Financial Report

of the Government of Canada

Fiscal Year 2004–2005

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Annual Financial Report

of the Government of Canada

Fiscal Year 2004–2005

The Government of Canada posted a budgetary surplus of $1.6 billion in 2004–05. This marks the 8th consecutive year in which it has recorded a surplus, after 27 years of consecutive deficits. The entire $1.6-billion surplus reduces the amount of federal debt.

As a result of the budgetary surpluses recorded since 1997–98, the federal debt (accumulated deficit) has been reduced by $63.0 billion to $499.9 billion from its peak of $562.9 billion in 1996–97. Taking all levels of government together,[1] the Organisation for Economic Co-operation and Development (OECD) estimates that Canada was the only Group of Seven (G7) country to post a surplus in 2004.

Federal debt as a percentage of the economy was 38.7 per cent in 2004–05, a reduction of 29.7 percentage points from its peak of 68.4 per cent in 1995–96. Canada has made more progress in reducing its debt burden than any other G7 country. From having the second highest debt burden among G7 countries in the mid-1990s, Canada's net debt burden for the total government sector was the lowest in 2004.

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[1] Includes federal, provincial-territorial and local governments as well as the Canada Pension Plan and Quebec Pension Plan.

Department of Finance Canada
Ministère des Finances Canada

The reduction in the federal debt burden is important for a variety of reasons. The reduction in the debt since 1997–98 has resulted in interest savings of over $3 billion annually. This money can now be used to fund valued programs and services. A lower debt burden also lessens the exposure of Canada's fiscal situation to economic shocks, especially an increase in interest rates. Sustained balanced budgets and putting the debt on a steady downward track have also restored Canada's triple-A credit rating in financial markets. Since this effectively sets the standard for the whole country, everyone benefits—from provinces and municipalities to individuals wanting to buy a home, start a business or run a farm.

The aging of Canada's population means that it is all the more critical to continue reducing the debt burden. The largest segment of the workforce was born during the post-war baby boom, and many of these workers are now approaching retirement. This will lead to growing demand for age-related public services at the same time that the number of people working to support those programs is shrinking. The less debt we carry, the greater the country's flexibility to fund those services and keep levels of taxation to a minimum. Because of this, the Government of Canada set a long-run objective of reducing the federal debt-to-GDP (gross domestic product) ratio to 25 per cent by 2014–15. This was the debt level that prevailed before the Government began to run large and persistent deficits in the early 1970s. The Government is well placed to achieve that objective.

Good fiscal management requires that the Government equip itself with the best possible economic and fiscal projections. To that end, last September I asked Dr. Tim O'Neill, a distinguished private sector economist, to undertake an examination of the federal government's fiscal forecasting accuracy. This examination is now complete. A copy of Dr. O'Neill's report was tabled in the House of Commons in June and can also be found on the Department of Finance website. The report sets out a number of recommendations, in particular for increasing the transparency in budget-related information and improving data quality and analysis. The Government is in complete agreement with the recommendations for transparency and data analysis, and intends to move forward in implementing them starting with the fall 2005 update.

The financial data in this report are based on the audited results, which will appear in more detail in the *Public Accounts of Canada 2005*, scheduled for tabling in the House of Commons this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 2004 to March 31, 2005) and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* publication has been updated to incorporate the results for 2004–05 and historical revisions to the *National Economic and Financial Accounts* published by Statistics Canada. These tables are an integral part of this report.

The Honourable Ralph Goodale, P.C., M.P.
Minister of Finance

Table of Contents

Note to Readers

The figures contained in the *Annual Financial Report* are presented on a net basis, consistent with the presentations in the budgets and in the Appropriation Acts, as approved by Parliament. In contrast, the figures in the *Public Accounts of Canada 2005* are presented on a gross basis. The differences in classification affect both budgetary revenues and program expenses by a corresponding amount and, as such, have no impact on the budgetary balance. The impact of these classification differences on budgetary revenues and program expenses is explained in this report.

The Government reports all revenues and expenses on an accrual basis. Further details on the Government's accounting policies can be found in the section entitled "Notes to the Condensed Financial Statements" and in the *Public Accounts of Canada 2005*.

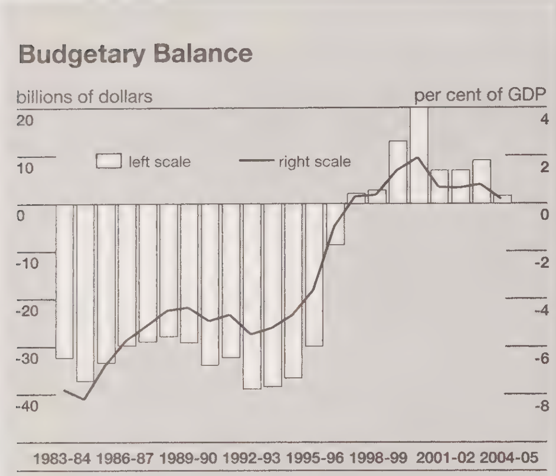
Report Highlights

- A budgetary surplus of $1.6 billion was achieved in 2004–05. This marks the eighth consecutive year the federal budget has been in surplus.
- Federal debt stood at $499.9 billion at the end of 2004–05, down $63.0 billion from its peak of $562.9 billion in 1996–97. The federal debt-to-GDP ratio is 38.7 per cent, down sharply from its peak of 68.4 per cent in 1995–96. It is now at its lowest level since 1983–84.
- Market debt—the debt issued on credit markets to investors—as a percentage of GDP has declined to 33.8 per cent from the peak of 58.2 per cent in 1995–96.
- The revenue-to-GDP ratio in 2004–05 was 15.4 per cent, up marginally from 15.3 per cent in 2003–04. The ratio has fallen by 1.6 percentage points since 2000–01, primarily reflecting the impact of the tax reductions announced in the February 2000 budget and October 2000 *Economic Statement and Budget Update.*
- The program expenses-to-GDP ratio increased to 12.6 per cent in 2004–05, up from 11.6 per cent in 2003–04, but remains well below levels recorded prior to actions taken in the mid-1990s to eliminate the deficit.
- Public debt charges declined by $1.7 billion in 2004–05. As a percentage of revenues, public debt charges were 17.2 per cent in 2004–05, down from a peak of about 39 per cent in 1990–91. The share of revenues devoted to public debt charges is now at its lowest level since the late 1970s.

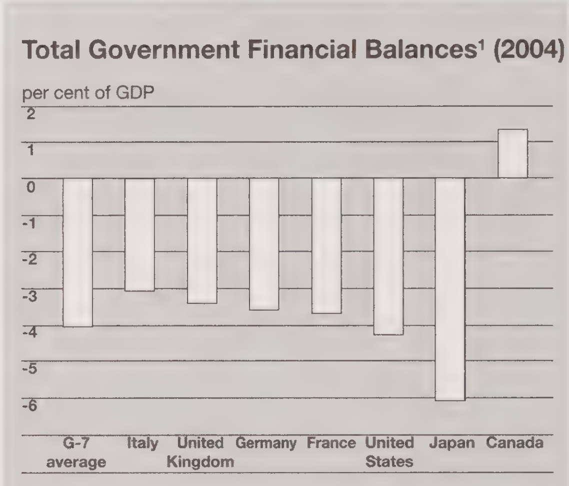
The Budgetary Balance

A budgetary surplus of $1.6 billion was recorded in 2004–05, down $7.5 billion from the surplus of $9.1 billion in 2003–04. Budgetary revenues increased by $12.2 billion, or 6.6 per cent, over the prior year, reflecting strong growth in the applicable tax bases and net gains from the sale of the Government's remaining shares in Petro-Canada in September 2004. Public debt charges declined by $1.7 billion, or 4.6 per cent, due to a decline in the stock of interest-bearing debt and a decline in the average effective interest rate on that debt. Program expenses increased by $21.3 billion, or 15.1 per cent. Approximately half of the increase, or $10.6 billion, is due to one-time spending, of which 80 per cent relates to transfers to provinces and territories. Excluding these one-time expenses, program spending was up 7.6 per cent. Transfers to provinces and territories (including both ongoing and one-time spending) accounts for almost 60 per cent of the increase in program spending in 2004–05.

In the February 2005 budget, the Government estimated the budgetary surplus at $3.0 billion for 2004–05. This amount was allocated to the Contingency Reserve. The decrease in the 2004–05 surplus compared to the February 2005 budget was attributable to higher-than-expected program expenses, partially offset by higher-than-expected budgetary revenues. Budgetary revenues were $2.6 billion higher than forecast, due primarily to stronger-than-expected growth in corporate income tax revenues and other revenues. Program expenses were $4.5 billion greater than forecast, primarily reflecting an increase in provisions for agricultural assistance and other liabilities, as well as a change in accounting for the Offshore Revenues Accords ($2.8 billion). At the time of the February 2005 budget, it was the Government's intention to expense this liability in annual instalments, consistent with the intent of the agreements. However, in the process of finalizing the financial statements, it was determined that the entire transfer should be expensed in 2004–05.



Sources: *Public Accounts of Canada* and Statistics Canada.



[1]The OECD uses the term "financial balance" to mean budgetary balance.

In the absence of policy changes, the budgetary balance primarily mirrors economic developments. To adjust for economic developments, the budgetary balance and its components are often presented as a percentage of GDP.

The budgetary surplus of $1.6 billion, or 0.1 per cent of GDP, in 2004–05 represents a substantial improvement from the deficit of $38.5 billion, or 5.3 per cent of GDP, in 1993–94. As a percentage of GDP, all of the fiscal improvement since 1993–94 is attributable to the decline in expenses (Table 1). Program expenses as a percentage of GDP declined from 15.7 per cent in 1993–94 to 12.6 per cent in 2004–05, while public debt charges fell from 5.5 per cent in 1993–94 to 2.6 per cent in 2004–05. In contrast, budgetary revenues fell from 16.0 per cent in 1993–94 to 15.4 per cent in 2004–05. The changes in the program expense and budgetary revenue ratios were due to discretionary policy actions. The decline in the public debt charge ratio was attributable to the decline in interest-bearing debt, due to a turnaround in the fiscal situation and a decline in interest rates.

Sound financial management has been at the core of the Government's economic strategy over the past 11 years. This strategy has put an end to almost three decades of chronic deficits and resulted in eight consecutive surpluses—an achievement unparalleled since Confederation.

According to OECD estimates for the total government sector,[2] Canada was the only G7 country to record a surplus in 2004. Canada's surplus for 2004 is estimated at 1.3 per cent of GDP, compared to an average deficit of 4.1 per cent in the G7 countries. Moreover, Canada is expected to continue to be the only G7 country to post a total government surplus again in 2005 and 2006, according to the OECD.

[2] Includes federal, provincial-territorial and local governments as well as the Canada Pension Plan and Quebec Pension Plan.

Table 1
Budgetary Revenues and Expenses

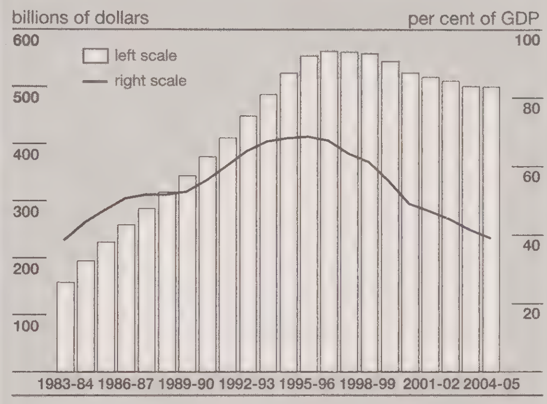
	1993–94	2004–05	Change[1]
		(per cent of GDP)	
Budgetary revenues	16.0	15.4	-0.6
Program expenses	15.7	12.6	3.1
Public debt charges	5.5	2.6	2.9
Budgetary balance	**-5.3**	**0.1**	**5.4**

[1] A negative number indicates a deterioration in the balance. A positive number indicates an improvement in the balance.

Federal Debt

The 2004–05 surplus of $1.6 billion brings the federal debt—the accumulation of annual deficits and surpluses since Confederation—down to $499.9 billion. From its peak of $562.9 billion in 1996–97, federal debt has declined by $63.0 billion. As a share of GDP, federal debt dropped to 38.7 per cent in 2004–05, down from the peak of 68.4 per cent in 1995–96. This is the ninth consecutive year in which the federal debt-to-GDP ratio has declined, bringing it to its lowest level since 1983–84. Federal debt at the end of 2004–05 was $15,544 for each Canadian, down from $15,742 a year earlier and down from $18,886 at the end of 1996–97, the last year the federal government recorded a deficit.

Federal Debt (Accumulated Deficit)



Sources: *Public Accounts of Canada* and Statistics Canada.

Federal Debt (Accumulated Deficit)

Since 2002–03, the financial statements of the Government of Canada have been presented on a full accrual basis of accounting. Under the previous accounting standard—modified accrual accounting—net debt and the accumulated deficit were identical. Under the new standard, net debt now includes a comprehensive costing for financial liabilities but excludes non-financial assets. The accumulated deficit includes both. It is the sum of all surpluses and deficits in the past.

Federal debt, referred to in the budget documents and the *Annual Financial Report of the Government of Canada,* is the accumulated deficit. It is the federal government's main measure of debt, as annual changes in this measure determine the budgetary balance.

Table 2
Financial Highlights

	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04	2004–05
				($ billions)				
Budgetary transactions								
Revenues	152.1	156.1	166.1	182.7	171.7	177.8	186.2	198.4
Expenses								
Program expenses	-106.9	-110.0	-109.6	-118.7	-125.0	-133.6	-141.4	-162.7
Public debt charges	-43.1	-43.3	-43.4	-43.9	-39.7	-37.3	-35.8	-34.1
Total expenses	-150.0	-153.3	-153.0	-162.6	-164.7	-170.9	-177.1	-196.8
Budgetary balance	**2.1**	**2.8**	**13.1**	**20.2**	**7.0**	**7.0**	**9.1**	**1.6**
Non-budgetary transactions	9.0	2.4	-5.3	-8.9	-7.4	0.6	-2.8	3.2
Financial source/requirement	11.1	5.2	7.9	11.3	-0.3	7.6	6.2	4.8
Net change in financing activities	-9.6	-6.2	-4.0	-10.0	-4.1	-2.5	-2.2	-4.8
Net change in cash balances	1.5	-1.0	3.8	1.3	-4.4	5.1	4.1	0.0
Cash balance at end of period	11.7	10.7	14.5	15.8	11.4	16.5	20.5	20.6
Financial position								
Total liabilities	711.3	714.9	715.8	715.1	704.3	700.1	701.1	705.7
Total financial assets	103.3	108.3	120.9	138.8	133.4	135.3	144.8	151.0
Net debt	607.9	606.6	595.0	576.3	570.9	564.8	556.3	554.7
Non-financial assets	47.2	48.7	50.2	51.7	53.4	54.2	54.8	54.9
Federal debt (accumulated deficit)	**560.7**	**557.9**	**544.7**	**524.6**	**517.5**	**510.6**	**501.5**	**499.9**
Financial results (% of GDP)								
Budgetary revenues	17.2	17.1	16.9	17.0	15.5	15.4	15.3	15.4
Program spending	12.1	12.0	11.2	11.0	11.3	11.5	11.6	12.6
Public debt charges	4.9	4.7	4.4	4.1	3.6	3.2	2.9	2.6
Budgetary balance	0.2	0.3	1.3	1.9	0.6	0.6	0.7	0.1
Federal debt (accumulated deficit)	63.5	61.0	55.4	48.7	46.7	44.1	41.1	38.7

Note: Numbers may not add due to rounding.

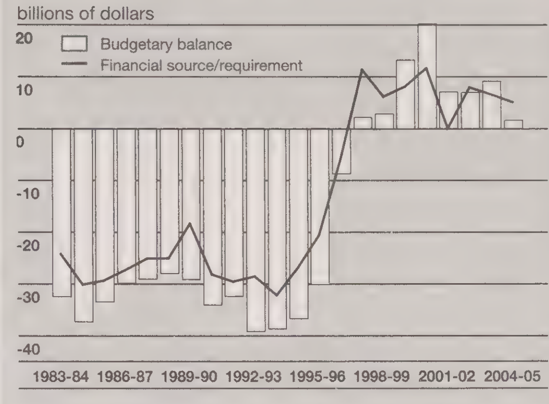
Federal debt consists of interest-bearing debt and accounts payable and accrued liabilities, net of financial and non-financial assets. Interest-bearing debt, in turn, consists of unmatured, or market, debt and the Government's obligations recorded in internally held accounts—primarily the liabilities for the federal government employees' pension plans.

The decrease in the federal debt of $1.6 billion in 2004–05 was attributable to an increase of $6.2 billion in financial assets—cash and tax receivables and loans, investments and advances—and a decline in market debt ($4.8 billion). These positive developments were largely offset by an increase of $10.5 billion in accounts payable and accrued liabilities. Non-financial assets were virtually unchanged.

Financial Source/Requirement

The financial source/requirement measures the difference between cash coming in to the Government and cash going out. There was a financial source of $4.8 billion in 2004–05, compared to a financial source of $6.2 billion in 2003–04. This lower source is primarily attributable to a lower budgetary balance.

Budgetary Balance and Financial Source/Requirement



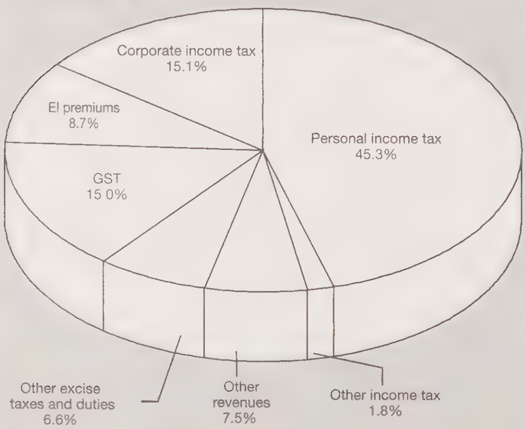
Sources: *Public Accounts of Canada* and Statistics Canada.

Budgetary Revenues

Budgetary revenues were reported at $198.4 billion, an increase of $12.2 billion, or 6.6 per cent, from 2003–04. Tax revenues rose by $9.4 billion, or 6.0 per cent, while employment insurance (EI) premium revenues fell by $0.2 billion, or 1.4 per cent. Other revenues increased by $3.1 billion, or 26.0 per cent. Total budgetary revenues were $2.6 billion, or 1.3 per cent, higher than estimated in the February 2005 budget.

The largest source of federal revenues is personal income tax revenues, which stood at 45.3 per cent of total revenues in 2004–05. Corporate income tax revenues were 15.1 per cent of total revenues, up 9.2 percentage points from a low of 5.9 per cent in 1992–93. EI premium revenues contributed to 8.7 per cent of total revenues, having dropped from a peak of 16.6 per cent in 1993–94 due to annual reductions in premium rates in each of the last 11 years.

Composition of Net Revenues for 2004–05



Source: *Public Accounts of Canada.*

Personal income tax revenues increased by $4.9 billion, or 5.8 per cent, in 2004–05. This growth is broadly in line with the growth of 4.3 per cent in personal income. The difference in growth rates reflects a number of factors, including the progressivity of the personal income tax system and the fact that personal income, as measured by Statistics Canada, excludes some components of taxable income, such as pension income and capital gains.

Corporate income tax revenues increased by $2.5 billion, or 9.2 per cent, in 2004–05. This rate of growth was about half the 18.7-per-cent growth in corporate profits in 2004 and down from the 23.4-per-cent increase in corporate income tax revenues recorded in 2003–04. The strong growth of corporate income tax revenues in 2003–04 was attributable to an extraordinary gain of $2.5 billion stemming from the revaluation of U.S.-dollar-denominated liabilities in the financial services sector. Excluding the impact of this one-time factor, the increase in corporate income tax revenues in 2004–05 was broadly in line with the growth in corporate profits.

Other taxes and duties increased by $1.5 billion, or 3.6 per cent, in 2004–05. This increase was primarily attributable to higher goods and services tax (GST) revenues (up $1.5 billion, or 5.2 per cent), in line with the growth in the applicable tax base. The other components of excise taxes and duties are small and volatile. The decline in the Air Travellers Security Charge reflects a reduction in rates, effective April 1, 2004.

EI premium revenues declined $0.2 billion, or 1.4 per cent, as the reduction in premium rates more than offset the impact of the increase in the number of people employed and therefore paying premiums. The employee premium rate (per $100 of insurable earnings) was reduced from $2.10 for 2003 to $1.98 for 2004.

Table 3
Revenues

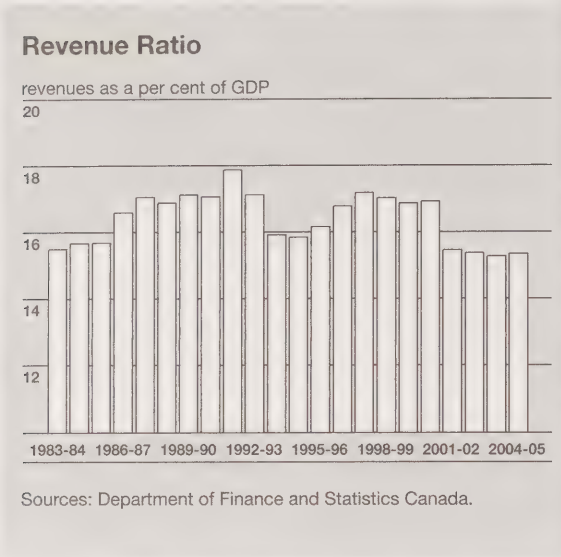
	2003–04	2004–05	Net change	
		($ millions)		(%)
Tax revenues				
Net income tax collections				
Personal income tax	84,895	89,833	4,938	5.8
Corporate income tax	27,431	29,956	2,525	9.2
Other income tax revenues	3,142	3,560	418	13.3
Total	115,468	123,349	7,881	6.8
Other taxes and duties				
Goods and services tax (GST)	28,286	29,758	1,472	5.2
Customs import duties	2,887	3,091	204	7.1
Energy taxes	4,952	5,054	102	2.1
Air Travellers Security Charge	410	370	-40	-9.8
Other excise taxes and duties	4,830	4,584	-246	-5.1
Total	41,365	42,857	1,492	3.6
Net tax revenues	**156,833**	**166,206**	**9,373**	**6.0**
Employment insurance premium revenues	17,546	17,307	-239	-1.4
Net other revenues				
Crown corporation revenues	4,719	5,321	603	12.8
Foreign exchange revenues	2,090	1,175	-915	-43.8
Other revenues	5,020	8,411	3,391	67.5
Total	11,828	14,907	3,078	26.0
Net budgetary revenues	**186,207**	**198,420**	**12,212**	**6.6**

Note: Numbers may not add due to rounding.

Other revenues consist of net gains/losses from Crown corporations, such as the Bank of Canada, Export Development Canada, and Canada Mortgage and Housing Corporation; foreign exchange revenues; and other revenues, primarily from the sale of goods and services. Other revenues were up $3.1 billion, or 26.0 per cent, primarily reflecting the $2.6-billion net gain the Government realized by selling its remaining shares in Petro-Canada, as well as higher profits from Crown corporations (up $0.6 billion). In contrast, foreign exchange revenues were down $0.9 billion, due to the appreciation in the value of the Canadian dollar.

The revenue ratio—budgetary revenues as a percentage of GDP—represents an approximate measure of the overall federal "tax burden" in that it compares the total of all federal revenues collected to the size of the economy. The revenue ratio stood at 15.4 per cent in 2004–05. It has been relatively stable since 2001–02, but is down significantly from an average ratio of 17.0 per cent over the period 1996–97 to 2000–01. This decline was primarily due to the tax reduction measures announced in the February 2000 budget and the October 2000 *Economic Statement and Budget Update*, which significantly reduced personal and corporate income taxes and EI premium rates.

It should be noted that some components of income subject to taxation are excluded from the Statistics Canada measure of GDP, such as capital gains and income from trusteed pension plans. As a result, this ratio overstates the effective tax burden. In addition, the nominal income estimates are subject to annual revision by Statistics Canada, which has resulted in changes in this ratio once revised data are incorporated. Therefore, caution should be exercised in interpreting this ratio.



The figures in Table 3 are presented on a "net" basis, reflecting the way in which revenues and expenses are presented to Parliament in the Government's annual budget. As a result, the Canada Child Tax Benefit is netted against personal income tax revenues. Departmental revenues that are levied for specific services, such as the contract costs of policing services in provinces, are netted against expenses, as such revenues are credited to the department in accordance with parliamentary authority. Revenues of consolidated Crown corporations are netted against their total expenses. This classification has the effect of reducing both revenues and expenses but has no impact on the budgetary balance. Table 4 shows the impact of "grossing up" budgetary revenues for these adjustments. In 2004–05, they amounted to $13.2 billion, up $0.9 billion from the previous fiscal year. The largest component is the Canada Child Tax Benefit, amounting to $8.7 billion in 2004–05, up 7.8 per cent from 2003–04. As a result, gross budgetary revenues were $211.7 billion in 2004–05, up 6.6 per cent from 2003–04.

Table 4

Reconciliation Between Net and Gross Budgetary Revenues

	2003–04	2004–05	Net change	
		($ millions)		(%)
Net budgetary revenues	**186,207**	**198,420**	**12,212**	**6.6**
Adjustments				
Canada Child Tax Benefit	8,062	8,688	626	7.8
Revenues netted against program expenses	3,076	3,044	-32	-1.0
Revenues of consolidated Crown corporations	1,201	1,506	304	25.3
Net adjustment	12,340	13,238	899	7.3
Gross budgetary revenues	**198,547**	**211,658**	**13,111**	**6.6**

Note: Numbers may not add due to rounding.

Total Expenses

Total expenses consist of two components—public debt charges and program expenses. In 2004–05 total expenses amounted to $196.8 billion, up $19.7 billion, or 11.1 per cent, from 2003–04 (Table 5). Public debt charges declined by $1.7 billion, or 4.6 per cent, while program expenses advanced $21.3 billion, or 15.1 per cent. Approximately 60 per cent of this increase (or $12.6 billion) was due to increases in transfers to other levels of government.

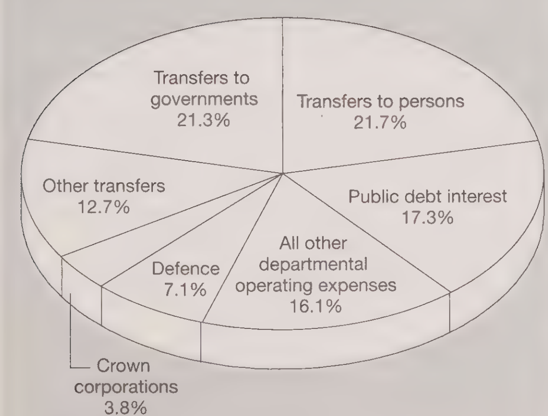
Total expenses for 2004–05 were $3.9 billion, or 2.0 per cent, higher than estimated in the February 2005 budget.

Major transfers to persons, consisting of elderly benefits and EI benefits, and major transfers to other levels of government (Canada Health and Social Transfer, fiscal arrangements and Alternative Payments for Standing Programs), are the two largest components of federal expenses, each representing just over 21 per cent of total spending. This is followed by public debt charges at 17.3 per cent, and other departmental and agency operating expenses at 16.1 per cent. There has been a shift in the composition of total expenses since the early 1990s. Public debt charges was the largest component for most of the 1990s, given the increase in the stock of interest-bearing debt and high average effective interest rates on that stock. With the elimination of the deficit, eight consecutive surpluses and a reduction in interest rates, its share has fallen over 14 percentage points from a high of nearly 32 per cent in 1996–97.

The expense ratio—total expenses as a percentage of budgetary revenues—stood at 99.2 per cent in 2004–05, up 4.1 percentage points from 2003–04. An expense ratio of less than 100 means that revenues exceed expenses, resulting in a surplus. Since the federal government first recorded a surplus in 1997–98, the expense ratio has been less than 100. This is in sharp contrast to the previous 27 years, in which revenues did not cover expenses, requiring the borrowing of the difference. The increase in the ratio since 2000–01 reflects the combination of the impact of the 2000 tax reductions and the introduction of new programs.

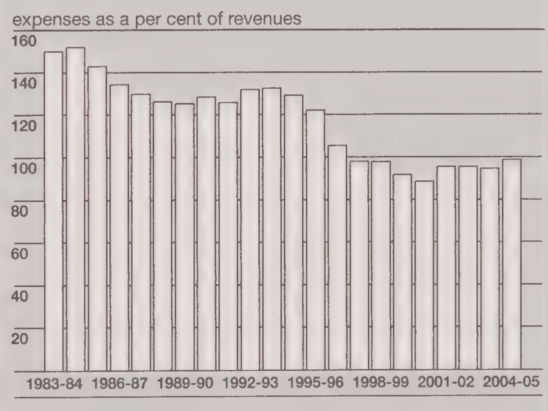
Public debt charges declined by $1.7 billion, or 4.6 per cent, to $34.1 billion in 2004–05, reflecting the impact of a decline in the stock of interest-bearing debt, along with a decline in the average effective interest rate on that debt.

Composition of Net Expenses for 2004–05



Source: *Public Accounts of Canada.*

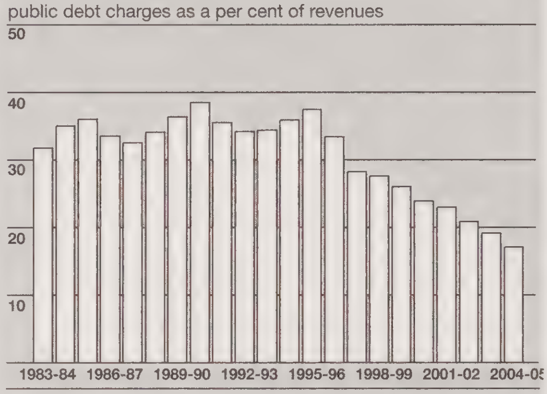
Expense Ratio



Source: Department of Finance.

- The average effective interest rate on the Government's interest-bearing debt (unmatured debt and pension liabilities) was 5.5 per cent in 2004–05, compared to 5.8 per cent in 2003–04. The average effective interest rate was 5.0 per cent on unmatured debt, compared to 5.3 per cent in 2003–04. In contrast, the average effective interest rate on pension and other accounts was 6.9 per cent, up 0.1 percentage points from 2003–04.
- The stock of total interest-bearing debt decreased by $5.9 billion, from $621.1 billion in 2003–04 to $615.3 billion in 2004–05. The stock of market debt declined by $4.8 billion to $435.5 billion, while liabilities to pension and other accounts decreased by $1.1 billion to $179.8 billion.

Interest Ratio



Source: Department of Finance.

The interest ratio—public debt charges as a percentage of budgetary revenues—declined from 19.2 per cent in 2003–04 to 17.2 per cent in 2004–05. This ratio means that, in 2004–05, the Government spent just over 17 cents of every revenue dollar on interest on the public debt. This is down from the peak of about 39 cents in 1990–91 and is the lowest this ratio has been since the late 1970s. This is money that must be paid to meet the Government's ongoing obligations on its debt. The lower the ratio, the more flexibility the Government has to address the key priorities of Canadians.

Program expenses amounted to $162.7 billion in 2004–05, an increase of $21.3 billion, or 15.1 per cent, from 2003–04. Increases were recorded in all major components, primarily reflecting the impact of previous budget measures.

Approximately half of the $21.3-billion increase was due to one-time spending, including:

- $4.3 billion for the Wait Time Reduction Fund;
- $2.8 billion for the Offshore Revenues Accords;
- $2.3 billion for Atomic Energy of Canada Limited (AECL) environmental liabilities;
- $700 million for early learning and child care; and
- $500 million for medical equipment.

Major transfer payments to persons increased by $0.7 billion, or 1.6 per cent.

- Elderly benefits consist of Old Age Security, Guaranteed Income Supplement and Allowance payments. Total benefits were up $1.0 billion, or 3.6 per cent, in 2004–05, reflecting both higher average benefits, which are indexed to inflation, and an increase in the number of recipients.
- EI benefits consist of regular benefits, special benefits (sickness, maternity, paternity, adoption and fishing) and labour market adjustment benefits. Total benefits decreased by $0.3 billion in 2004–05. The decline in benefit payments was attributable to a decrease in regular benefits, which is in line with improvements in the labour market.

Table 5

Total Expenses

	2003–04	2004–05	Net change	
		($ millions)		(%)
Transfers payments				
Major transfers to persons				
Elderly benefits	26,902	27,871	969	3.6
Employment insurance benefits	15,058	14,748	-310	-2.1
Total	41,960	42,619	659	1.6
Major transfers to other levels of government				
Support for health and other social programs	20,341	23,081	2,740	13.5
Canada Health and Social Transfer supplement	2,000		-2,000	
Wait Times Reduction Fund		4,250	4,250	
Medical Equipment Fund		500	500	
Early learning and child care		700	700	
National Immunization Fund	400		-400	
Fiscal arrangements and other transfers	9,351	13,340	3,989	42.7
Offshore Revenues Accords		2,830	2,830	
Alternative Payments for Standing Programs	-2,700	-2,746	-46	1.7
Total	29,392	41,955	12,563	42.7
Subsidies and other transfers[1]	22,964	25,001	2,037	8.9
Total transfer payments	94,316	109,575	15,259	16.2
Other program expenses				
Crown corporations				
Canada Mortgage and Housing Corporation	2,092	2,072	-20	-0.9
Canadian Broadcasting Corporation	1,066	1,037	-29	-2.7
Other cultural agencies	539	618	79	14.6
Canadian Air Transport Security Authority	351	501	150	42.6
Other	1,316	3,173	1,857	141.1
Total	5,365	7,401	2,037	38.0
Defence	12,449	13,924	1,475	11.8
All other departments and agencies	29,225	31,772	2,547	8.7
Total other program expenses	47,039	53,097	6,057	12.9
Net program expenses	**141,355**	**162,672**	**21,316**	**15.1**
Public debt charges	35,769	34,118	-1,651	-4.6
Net expenses	**177,124**	**196,790**	**19,665**	**11.1**

[1] See Table 6 for details.

Note: Numbers may not add due to rounding.

Major transfer payments to other levels of government include the Canada Health Transfer (CHT), the Canada Social Transfer (CST), fiscal arrangements (equalization, transfers to the territories, as well as a number of smaller transfer programs), transfers under the Offshore Revenues Accords, and Alternative Payments for Standing Programs. Transfers increased by $12.6 billion, or 42.7 per cent, in 2004–05, following a decrease of $1.3 billion, or 4.1 per cent, in 2003–04.

- The CHT and CST—block-funded transfers—support health care, post-secondary education, social assistance and social services, including early childhood development. These programs provide support in the form of cash and tax transfers to the provinces and territories. As part of the First Ministers' Meeting on health in September 2004, the Government provided the provinces and territories with an additional $5.75 billion for health in 2004–05, including $4.25 billion for a Wait Times Reduction Fund, $1.0 billion to close the short-term "Romanow gap," and $0.5 billion for medical equipment. In addition, the 2005 budget provided $0.7 billion to provinces and territories for early learning and child care programs.
- Total entitlements under fiscal arrangements and other transfers increased by $4.0 billion to $13.3 billion in 2004–05. Under the equalization program, the federal government transfers funds to the less prosperous provinces so that they can provide their residents with public services reasonably comparable to those in other provinces without having to resort to higher-than-average taxation. As part of the First Ministers' Meeting on equalization and Territorial Formula Financing in October 2004, the Government provided provinces and territories with an incremental $1.5 billion. Most of the remaining difference in fiscal arrangements was attributable to the recording of receivables in 2003–04 with respect to equalization overpayments in previous years, which depressed equalization entitlements in that year.
- The Offshore Revenues Accords, signed in February 2005, are designed to provide the provinces of Nova Scotia and Newfoundland and Labrador with additional payments to provide 100-per-cent offset against reductions in equalization payments resulting from offshore resource revenues. Budget 2005 provided the provinces with a minimum commitment of $2.8 billion under these agreements, all of which has been expensed in 2004–05.
- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allow provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provides provinces with tax points, the value of which are netted against total entitlements and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Subsidies and other transfers advanced by $2.0 billion, or 8.9 per cent (Table 6). The increase in this component was attributable to transfers to foundations included in Budget 2005, as well as new policy initiatives announced in previous budgets, including a commitment to increase Canada's international assistance by 8 per cent per year, increased funding for the federal granting councils, and increased support for the development and commercialization of environmental technologies.

Table 6
Subsidies and Other Transfers

	2003–04	2004–05	Net change	
		($ millions)		(%)
Agriculture and Agri-Food				
BSE recovery program	1,401	1,488	87	6.2
Other	2,519	1,264	-1,255	-49.8
Foreign Affairs and International Trade	2,683	3,408	725	27.0
Health Canada				
First Nations and Inuit health	702	779	77	11.0
Canadian Institutes of Health Research	647	705	58	8.9
Primary Health Care Transition Fund	209	211	2	0.8
Grant to Ontario: SARS	330		-330	
Other	576	381	-194	-33.7
Human Resources and Skills Development				
Student assistance programs	804	759	-46	-5.7
Labour market programs	735	500	-235	-32.0
Canadian Council on Learning	85		-85	
Other	407	358	-50	-12.2
Indian Affairs and Northern Development	4,794	4,934	139	2.9
Industry/regional agencies/granting councils				
Technology Partnerships Canada	312	304	-8	-2.5
Infrastructure Canada	334	398	64	19.1
Regional agencies	761	563	-199	-26.1
Natural Sciences and Engineering Research Council of Canada/Social Sciences and Humanities Research Council of Canada	1,134	1,263	129	11.4
Other	492	377	-114	-23.2
Canada Health Infoway	100		-100	
Genome Canada		225	225	
Green Municipal Fund		300	300	
Sustainable Development Technology Canada	250	200	200	-20.0
Other	3,687	6,584	2,897	78.6
Total	**22,964**	**25,001**	**2,037**	**8.9**

Note: Numbers may not add due to rounding.

Other program expenses—total program expenses less transfers—consist of expenses related to Crown corporations, and operating expenses of departments and agencies, including National Defence. These expenses amounted to $53.1 billion in 2004–05, up $6.1 billion, or 12.9 per cent, from 2003–04. Within this component:

- Expenses related to Crown corporations were up by $2.0 billion to $7.4 billion in 2004–05. This component includes appropriations to consolidated Crown corporations (those Crown corporations that rely on government funding as their principal source of revenue).

  The increase in Crown corporation expenses was due mainly to a $2.3-billion expense recorded by AECL for environmental liabilities, reflecting changes in its decommissioning plan and underlying assumptions.

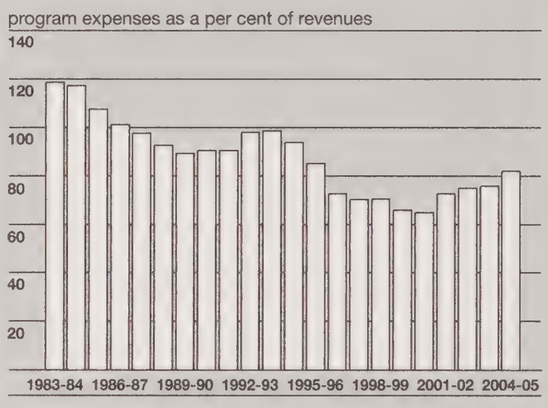
- Defence expenses increased by $1.5 billion, or 11.8 per cent, primarily reflecting incremental annual funding to strengthen Canada's military.

- All other departmental and agency expenses increased by $2.5 billion, or 8.7 per cent, due to higher operating costs as well as previous budget measures.

The program share—program expenses as a percentage of budgetary revenues—amounted to 82.0 per cent in 2004–05, up from 75.9 per cent in 2003–04.

The above numbers are presented on a "net" basis, as discussed in the previous section, "Budgetary Revenues." Gross expenses are $13.2 billion higher than net expenses, as shown in Table 7.

Program Share



Source: Department of Finance.

Table 7
Reconciliation Between Net and Gross Expenses

	2003–04	2004–05	Net change	
		($ millions)		(%)
Net expenses	**177,124**	**196,790**	**19,665**	**11.1**
Adjustments				
Canada Child Tax Benefit	8,062	8,688	626	7.8
Revenues netted against program expenses	3,076	3,044	-32	-1.0
Revenues of consolidated Crown corporations	1,201	1,506	304	25.3
Net adjustment	12,340	13,238	899	7.3
Gross expenses	**189,464**	**210,028**	**20,564**	**10.9**

Note: Numbers may not add due to rounding.

THE BUDGETARY BALANCE, FINANCIAL SOURCE/REQUIREMENT AND DEBT

The budgetary balance is the most comprehensive measure of the federal government's fiscal results. It is presented on a full accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made, and recording tax revenues when earned, regardless of when the cash is received.

In contrast, the financial source/requirement measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance in that it includes cash transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, foreign exchange activities, and changes in other financial assets, liabilities and non-financial assets. These activities are included as part of non-budgetary transactions. The conversion from full accrual to cash accounting is also reflected in non-budgetary transactions.

Non-budgetary transactions in 2004–05 resulted in a net source of funds amounting to $3.2 billion, compared to a requirement of $2.8 billion in 2003–04. This turnaround largely reflects a change in the timing of the recognition and settlement of liabilities over the two years. In 2004–05, significant liabilities were recorded for which payment will not occur until future periods, such as $2.8 billion for the Offshore Revenues Accords and $2.3 billion for AECL's environmental liabilities. In contrast, in 2003–04 significant payments were made to settle liabilities recorded in prior years, such as the 2003 Canada Health and Social Transfer supplement ($2.5 billion) and the 2003 Medical Equipment Trust ($1.5 billion). The increase in cash inflows arising from accounts payable and accrued liabilities was partially offset by increased requirements for other investing activities, primarily for increased loans under the Canada Student Loans Program, and increased requirements relating to the transfer of the Government's holdings in the Canada Pension Plan to the Canada Pension Plan Investment Board.

With a budgetary surplus of $1.6 billion and a net source from non-budgetary transactions of $3.2 billion, there was a financial source of $4.8 billion in 2004–05, compared to a source of $6.2 billion in 2003–04 (Table 8).

With this financial source, the Government retired $4.8 billion of its market debt and increased its cash balances by $49 million. Cash balances at March 31, 2005, stood at $20.6 billion.

Total liabilities consist of interest-bearing debt and accounts payable and accrued liabilities. Interest-bearing debt includes market debt and liabilities for pension and other accounts. At March 31, 2005, interest-bearing debt amounted to $615.3 billion, down $5.9 billion from a year earlier (Table 9). Accounts payable and accrued liabilities amounted to $90.5 billion, up $10.5 billion from 2003–04 due to previous budget measures and increased provisions for liabilities. As a result, total liabilities at March 31, 2005, stood at $705.7 billion, up $4.6 billion from the previous year.

Financial assets consist of cash and accounts receivable, including tax receivables, foreign exchange accounts and loans, investments and advances. Financial assets totalled $151.0 billion at March 31, 2005, up $6.2 billion from March 31, 2004. Increases were recorded in cash and accounts receivable (up $5.4 billion) and in loans, investments and advances (up $4.3 billion) while net assets in foreign exchange accounts declined by $3.4 billion. The latter primarily reflects revaluation losses due to appreciation of the Canadian dollar. As a result, net debt stood at $554.7 billion at March 31, 2005, down $1.6 billion from March 31, 2004, and $54.2 billion below the peak of $609 billion at March 31, 1997. As a percentage of GDP, net debt dropped to 43.0 per cent in 2004–05, down 30.9 percentage points from its peak of 73.9 per cent in 1995–96. This is the ninth consecutive year in which the net debt-to-GDP ratio has declined.

Table 8

Budgetary Balance, Financial Source/Requirement and Net Financing Activities

	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04	2004–05
				($ billions)				
Surplus for the year	**2.1**	**2.8**	**13.1**	**20.2**	**7.0**	**7.0**	**9.1**	**1.6**
Non-budgetary transactions								
Pensions and other accounts								
Public sector pensions (net)	3.3	5.0	5.9	0.8	-2.3	-1.2	1.9	2.0
Canada Pension Plan	0.5	1.2	0.8	0.2	0.4	0.3	0.4	-4.7
Other	0.9	1.1	0.8	2.2	0.9	1.2	0.4	1.6
Total	4.6	7.3	7.6	3.2	-1.0	0.3	2.6	-1.1
Capital investing activities	-3.3	-3.7	-3.8	-3.8	-4.4	-4.8	-4.4	-4.5
Other investing activities	2.8	3.4	3.1	0.4	1.5	0.5	-2.4	-4.3
Other activities								
Accounts payable, receivable, accruals and allowances	4.7	-1.1	-7.6	-2.3	-4.2	-1.9	-6.8	5.9
Foreign exchange activities	-2.2	-5.7	-6.8	-8.8	-1.8	3.1	4.6	3.4
Amortization of tangible capital assets	2.3	2.3	2.3	2.3	2.6	3.3	3.5	3.7
Total other activities	4.9	-4.5	-12.2	-8.8	-3.4	4.6	1.4	13.0
Total non-budgetary transactions	9.0	2.4	-5.3	-8.9	-7.4	0.6	-2.8	3.2
Financial source/requirement	**11.1**	**5.2**	**7.9**	**11.3**	**-0.3**	**7.6**	**6.2**	**4.8**
Net change in financing activities								
Marketable bonds	15.8	9.6	-0.9	1.0	-1.1	-5.6	-9.5	-12.2
Treasury bills	-23.1	-15.4	2.9	-11.2	5.5	10.4	9.0	13.8
Canada Savings Bonds	-2.7	-2.1	-1.2	-0.4	-2.3	-1.4	-1.3	-2.3
Other	0.4	1.7	-4.9	0.5	-6.2	-5.9	-0.4	-4.1
Total	-9.6	-6.2	-4.0	-10.0	-4.1	-2.5	-2.2	-4.8
Change in cash balances	1.5	-1.0	3.8	1.3	-4.4	5.1	4.1	0.0
Cash at end of year	**11.7**	**10.7**	**14.5**	**15.8**	**11.4**	**16.5**	**20.5**	**20.6**

Note: Numbers may not add due to rounding.

Non-financial assets, consisting of tangible capital assets, inventories and prepaid expenses, amounted to $54.9 billion at March 31, 2005, up marginally by $48 million from March 31, 2004.

With total liabilities of $705.7 billion, financial assets of $151.0 billion and non-financial assets of $54.9 billion, the federal debt (accumulated deficit) stood at $499.9 billion at March 31, 2005, down a total of $1.6 billion from 2003–04 and $63.0 billion from its peak in 1996–97. The decline in federal debt between 2003–04 and 2004–05 was largely attributable to the decrease in interest-bearing debt and an increase in financial assets.

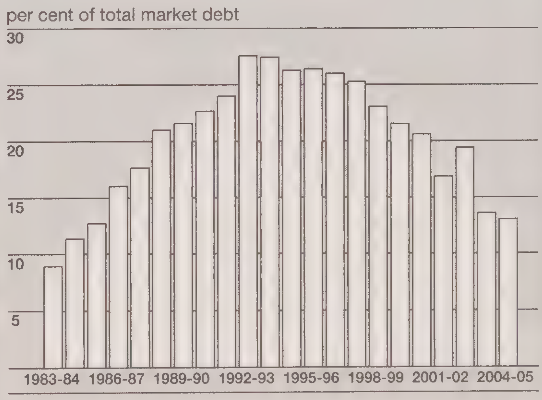
Table 9
Outstanding Debt at Year-End

	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04	2004–05
				($ billions)				
Liabilities								
Accounts payable and accrued liabilities	81.2	83.7	81.1	87.2	81.5	79.4	80.0	90.5
Interest-bearing debt								
Unmatured debt	469.2	463.0	459.0	449.0	444.9	442.4	440.2	435.5
Pension and other accounts	160.9	168.2	175.8	179.0	177.9	178.3	180.9	179.8
Total	630.1	631.2	634.8	628.0	622.8	620.7	621.1	615.3
Total liabilities	711.3	714.9	715.8	715.1	704.3	700.1	701.1	705.7
Financial assets								
Cash and accounts receivable	55.2	55.9	61.0	67.0	59.8	62.6	70.9	76.3
Foreign exchange accounts	29.0	34.7	41.5	50.3	52.0	49.0	44.3	40.9
Loans, investments and advances	19.2	17.8	18.4	21.6	21.6	23.7	29.5	33.9
Total financial assets	103.3	108.3	120.9	138.8	133.4	135.3	144.8	151.0
Net debt	**607.9**	**606.6**	**595.0**	**576.3**	**570.9**	**564.8**	**556.3**	**554.7**
Non-financial assets								
Tangible capital assets	40.2	41.5	42.9	44.2	45.7	47.0	47.7	48.2
Inventories	6.2	6.3	6.5	6.6	6.4	6.1	6.1	5.5
Prepaid expenses	0.9	0.9	0.9	0.9	1.2	1.1	0.9	1.1
Total non-financial assets	47.2	48.7	50.2	51.7	53.4	54.2	54.8	54.9
Federal debt (accumulated deficit)	**560.7**	**557.9**	**544.7**	**524.6**	**517.5**	**510.6**	**501.5**	**499.9**

Note: Numbers may not add due to rounding.

Foreign holdings of the Government of Canada's outstanding market debt are estimated at $56.9 billion at the end of March 2005, representing 13.1 per cent of the Government's total market debt. This is down from the end of March 2004, when foreign holdings stood at $60.0 billion, or 13.6 per cent, of total market debt.

Foreign Holdings of Government of Canada Debt



Sources: Department of Finance and Statistics Canada.

Comparison of Actual Budgetary Outcomes to Budget Estimates

This section compares the actual outcome for the major components of the budgetary balance for 2004–05 to the estimates presented in the February 2005 budget. The Government targeted a balanced budget or better for 2004–05 in the February 2005 budget. Under the Debt Repayment Plan, the fiscal target for each year is based on:

- Using the average of private sector economic forecasts for budget-planning purposes.
- Including an annual Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. It is not a source of funding for new policy initiatives. If not needed, it is used to reduce the federal debt.
- Adding an extra degree of economic prudence to provide further assurance against falling back into deficit. As is the normal practice, no additional prudence was added in the February 2005 budget for 2004–05, given that the fiscal year was nearly over.

After accounting for the fiscal impact of the new spending initiatives, the February 2005 budget estimated a surplus of $3.0 billion for 2004–05. This amount was allocated to the Contingency Reserve. The final audited budgetary surplus for 2004–05 was $1.6 billion.

Most of this variance was attributable to higher program expenses, up $4.5 billion from that estimated in the February 2005 budget. The higher expenses primarily relate to increased transfers to other levels of government and increased assistance to the agricultural sector. These higher expenses were partially offset by a $2.6-billion increase in budgetary revenues, reflecting stronger-than-expected receipts in the final quarter of the 2004–05 fiscal year.

Within program expenses, EI benefits were $0.5 billion lower than expected, reflecting stronger employment gains in the final quarter of 2004–05, while elderly benefits were marginally lower ($0.1 billion). Major transfers to other levels of government were $2.9 billion higher than expected, due largely to the recording in 2004–05 of the entire $2.8-billion transfer under the February 2005 Offshore Revenues Accords. At the time of the February 2005 budget, it was the Government's intention to expense this liability in annual instalments, consistent with the intent of the agreements. However, after further consideration and discussions with the Auditor General, the Government concluded that, on balance, the evidence supports expensing the entire transfer in 2004–05.

Other expenses were $2.3 billion higher than forecast due to the $1-billion agricultural assistance package announced in March 2005 and increased provisions for liabilities, including AECL environmental liabilities.

Public debt charges were $0.6 billion lower than estimated, due to lower effective interest rates.

Information received after finalizing the estimates for the February 2005 budget indicated that some components of revenues were higher than expected. Corporate income tax revenues were $1.5 billion greater due to higher-than-expected year-end settlement payments from the manufacturing and energy sectors, which were received in February and March. Higher net gains from Crown corporations and other miscellaneous revenues explain most of the $1.2-billion increase in other revenues. The final outcome for 2004–05 indicates that the revenue yield was higher than expected at the time of the February 2005 budget.

Table 10

Comparison of Actual Outcomes to February 2005 Budget

	Actual	2005 budget	Difference
		($ billions)	
Budgetary revenues			
Personal income tax	89.8	89.6	0.2
Corporate income tax	30.0	28.4	1.5
Other income tax	3.6	3.6	0.0
Excise taxes and duties	42.9	43.4	-0.6
Employment insurance premium revenues	17.3	17.1	0.2
Other revenues	14.9	13.8	1.2
Total	198.4	195.8	2.6
Program expenses			
Major transfers to persons			
Elderly benefits	27.9	28.0	-0.1
Employment insurance benefits	14.7	15.3	-0.5
Major transfers to other levels of government			
Canada Health and Social Transfer	28.5	28.5	0.0
Fiscal arrangements	16.2	13.3	2.9
Alternative Payments for Standing Programs	-2.7	-2.7	0.0
All other expenses	78.1	75.8	2.3
Total	162.7	158.1	4.5
Public debt charges	34.1	34.7	-0.6
Budgetary outcome/estimate	**1.6**	**3.0**	**-1.4**

Note: Numbers may not add due to rounding.

Auditor General of Canada
Vérificatrice générale du Canada

Report of the Auditor General on the Condensed Financial Statements of the Government of Canada

To the Minister of Finance:

The accompanying condensed statements of operations and accumulated deficit, financial position, change in net debt and cash flow are derived from the complete financial statements of the Government of Canada as at March 31, 2005, and for the year then ended on which I expressed an opinion without reservation in my Report to the House of Commons dated August 31, 2005.

For more complete information, readers should refer to my Report, which will be included in Volume I of the *Public Accounts of Canada 2005*, expected to be tabled in the House of Commons later this year.

The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility, in accordance with the applicable Assurance Guideline of The Canadian Institute of Chartered Accountants, is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria described in the Guideline referred to above.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and cash flow, reference should be made to the related complete financial statements, which will also be included in Volume I of the *Public Accounts of Canada 2005*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
August 31, 2005

Condensed Financial Statements of the Government of Canada

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs and resources for which the Government is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the Government.

These financial statements are extracted and condensed from the audited financial statements included in Section 2 of Volume I of the *Public Accounts of Canada 2005*, which are expected to be tabled in Parliament later this year. As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 11

Government of Canada
Condensed Statement of Operations and Accumulated Deficit
for the Year Ended March 31, 2005

	2005		2004
	Budget[1]	Actual	Actual
		($ millions)	
Revenues			
Income tax	125,200	132,037	123,530
Other taxes and duties	41,700	42,857	41,365
Employment insurance premiums	17,000	17,307	17,546
Other revenues	16,900	19,457	16,106
Total revenues	***200,800***	***211,658***	***198,547***
Expenses			
Transfer payments			
Old age security and related payments	27,900	27,871	26,902
Other levels of government	30,600	41,955	29,392
Employment insurance benefits	15,700	14,748	15,058
Other transfer payments	32,800	33,689	31,026
Total transfer payments	*107,000*	*118,263*	*102,378*
Other program expenses	54,400	57,647	51,317
Total program expenses	***161,400***	***175,910***	***153,695***
Public debt charges	35,400	34,118	35,769
Total expenses	***196,800***	***210,028***	***189,464***
Annual surplus	**4,000**[2]	**1,630**	**9,083**
Accumulated deficit, beginning of year	501,500[3]	501,493	510,576
Accumulated deficit, end of year	**497,500**	**499,863**	**501,493**

[1] Derived from Budget 2004 and adjusted to a gross basis.

[2] Budget 2004 disclosed the budgetary surplus as $4 billion before deducting reserves for contingency ($3 billion) and economic prudence ($1 billion).

[3] Adjusted to the actual closing amount of previous year.

Table 12

Government of Canada
Condensed Statement of Financial Position
as at March 31, 2005

	2005	2004
	($ millions)	
Liabilities		
Accounts payable and accrued liabilities	90,473	79,964
Interest-bearing debt		
Unmatured debt	435,460	440,231
Pension and other liabilities	179,808	180,898
Total interest-bearing debt	*615,268*	*621,129*
Total liabilities	***705,741***	***701,093***
Financial assets		
Cash and accounts receivable	76,281	70,921
Foreign exchange accounts	40,871	44,313
Loans, investments and advances	33,860	29,548
Total financial assets	***151,012***	***144,782***
Net debt	***554,729***	***556,311***
Non-financial assets		
Tangible capital assets	48,207	47,745
Other	6,659	7,073
Total non-financial assets	***54,866***	***54,818***
Accumulated deficit	**499,863**	**501,493**

Table 13

Government of Canada
Condensed Statement of Change in Net Debt
for the Year Ended March 31, 2005

	2005		2004
	Budget[1]	Actual	Actual
		($ millions)	
Net debt, beginning of year	**556,300**[2]	**556,311**	**564,816**
Change in net debt during the year			
Annual surplus	(4,000)[3]	(1,630)	(9,083)
Acquisition of tangible capital assets	4,600	4,619	4,535
Amortization of tangible capital assets	(3,100)	(3,696)	(3,502)
Other		(875)	(455)
Net decrease in net debt	(2,500)	(1,582)	(8,505)
Net debt, end of year	**553,800**	**554,729**	**556,311**

1 Derived from Budget 2004.

2 Adjusted to the actual closing amount of previous year.

3 Budget 2004 disclosed the budgetary surplus as $4 billion before deducting reserves for contingency ($3 billion) and economic prudence ($1 billion).

Table 14

Government of Canada
Condensed Statement of Cash Flow
for the Year Ended March 31, 2005

	2005	2004
	($ millions)	
Cash provided by operating activities		
Annual surplus	1,630	9,083
Items not affecting cash	4,508	4,031
	6,138	**13,114**
Cash used for capital investment activities	**(4,475)**	**(4,444)**
Cash provided by (used for) investing activities	**3,157**	**(2,425)**
Total cash generated	***4,820***	***6,245***
Cash used to repay unmatured debt	**(4,771)**	**(2,185)**
Net increase in cash	**49**	**4,060**
Cash at beginning of year	20,546	16,486
Cash at end of year	**20,595**	**20,546**

Notes to the Condensed Financial Statements

1. Significant Accounting Policies

The Government of Canada reporting entity includes all departments, agencies, corporations and funds which are owned or controlled by the Government and which are accountable to Parliament. The financial activities of all these entities are consolidated in these statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the Government for financing their activities. These corporations are reported under the modified equity basis of accounting. The Canada Pension Plan is excluded from the reporting entity as it is under the joint control of the Government and participating provinces.

The Government accounts for transactions on an accrual basis. Financial assets recorded on the Condensed Statement of Financial Position can provide resources to discharge liabilities or finance future operations and are recorded at the lower of cost or net realizable value. Non-financial assets cannot normally be converted into cash to finance future operations without disrupting government operations; they are recorded at cost less accumulated amortization. Liabilities are recorded at the estimated amount ultimately payable, with pension and other similar benefits being determined on an actuarial basis. Valuation allowances are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the Government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable.

2. Contractual Obligations

Contractual obligations that will materially affect the level of future expenses include transfer payment agreements, acquisitions of goods and services, operating leases and funding of international organizations. At March 31, 2005, contractual obligations amounted to approximately $63 billion ($56 billion in 2004).

3. Contingent Liabilities

Guarantees by the Government amount to $68 billion ($71 billion in 2004) net of any recorded allowance. In addition, there are a number of contaminated sites where the Government could be obligated to incur costs. There are thousands of claims and pending and threatened litigation cases against the Government; the total amount claimed in these instances is significant but the final outcome is not determinable. Where cases are likely to be lost and an estimate of loss can be made, an amount is recorded in the financial statements. Insurance in force relating to self-sustaining insurance programs operated by three enterprise Crown corporations amounted to approximately $719 billion ($688 billion in 2004). The Government expects that it will not incur any costs to cover insurance claims under these programs.

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Government
Publications

ANNUAL FINANCIAL REPORT OF THE GOVERNMENT OF CANADA

Fiscal Year 2005–2006

CANADA'S NEW GOVERNMENT

TURNING A NEW LEAF

Canada

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ANNUAL FINANCIAL REPORT

OF THE GOVERNMENT OF CANADA

Fiscal Year 2005–2006

The Government of Canada posted a budgetary surplus of $13.2 billion in 2005–06. The surplus reflects strong revenue growth and effective management of spending by the Government. Taking all levels of government together, the Organisation for Economic Co-operation and Development (OECD) estimates that Canada was the only Group of Seven (G7) country to post a surplus in 2005.

A core priority of the Government is to improve the accountability and transparency of government operations to Canadians. This includes the financial reporting on those operations. Full and clear information on programs and operations allows citizens and Parliament to hold the Government accountable for its actions and results. To this end, the Government has taken a number of steps to improve the transparency of its financial reporting in 2005–06, including moving the presentation of revenues and expenses in the *Annual Financial Report of the Government of Canada* from a net to a gross basis, incorporating the results of certain foundations within the Government's financial statements, and publishing quarterly updates of the Government's fiscal forecast for the current year.

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Department of Finance Canada
Ministère des Finances Canada

The Government is committed to managing overall spending to ensure that government programs focus on results and value for money, and are consistent with government priorities and responsibilities. The 2005–06 surplus was $5.2 billion higher than forecast in the May 2006 budget due largely to lower than planned program expenses. Program expenses fell by 0.7 per cent in 2005–06, marking the first decline in nine years.

Federal debt as a percentage of gross domestic product (GDP) was 35.1 per cent in 2005–06, down 33.3 percentage points from its peak of 68.4 per cent in 1995–96. It is now at its lowest level in 24 years. Canada's net debt burden is the lowest in the G7.

In the 2006 budget, the Government set an objective of reducing the federal debt-to-GDP ratio to 25 per cent by 2013–14. The results for 2005–06 indicate that it is well placed to achieve that objective.

The financial data in this report are based on the audited results, which will appear in more detail in the 2006 *Public Accounts of Canada*, scheduled for tabling in the House of Commons later this fall. They cover the federal government's spending and revenue performance for the past fiscal year (April 1, 2005 to March 31, 2006) and detail the factors affecting these results. In addition, the *Fiscal Reference Tables* publication has been updated to incorporate the results for 2005–06. These tables are an integral part of this report.

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance

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Note to Readers

As announced in the May 2006 budget, revenues and expenses reported in the *Annual Financial Report of the Government of Canada* are now presented on a gross basis. Previously, they were presented on a net basis, whereby certain disbursements were netted against budgetary revenues and certain revenues were netted against expenses. The move to the gross basis brings the presentation of revenues and expenses in the Annual Financial Report in line with the presentation of annual audited results reported in the *Public Accounts of Canada*.

There are three major components that are affected by the move to the gross basis of presentation:

- The Canada Child Tax Benefit is now accounted for as an expense, whereas previously it was netted against personal income tax revenues.
- Departmental revenues that are levied for specific services, such as the contract costs of policing services in provinces, are now included in revenues, whereas previously these were netted against expenses.
- Revenues of consolidated Crown corporations are now included in revenues, whereas previously these were netted against their total expenses.

This change in presentation increases both budgetary revenues and expenses by the same amount and has no impact on the budgetary balance.

During 2005–06, the Government retroactively adopted the new recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants regarding the government reporting entity. The new standard expanded the definition of control. As a consequence, some organizations that were previously not part of the Government's reporting entity are now included in the Government's financial statements through consolidation. These organizations include:

- Canada Foundation for Innovation.
- Canada Millennium Scholarship Foundation.
- Sustainable Development Technology Canada.
- Aboriginal Healing Foundation.
- St. Lawrence Seaway Management Corporation.

This change resulted in a restatement of prior years' results and federal debt.

The Government reports all revenues and expenses on an accrual basis. Further details on the Government's accounting policies can be found in the section entitled "Notes to the Condensed Financial Statements of the Government of Canada" and in the *2006 Public Accounts of Canada*.

The *Fiscal Reference Tables* have been revised to reflect the changes mentioned above as well as historical revisions to the *National Economic and Financial Accounts* published by Statistics Canada.

Report Highlights

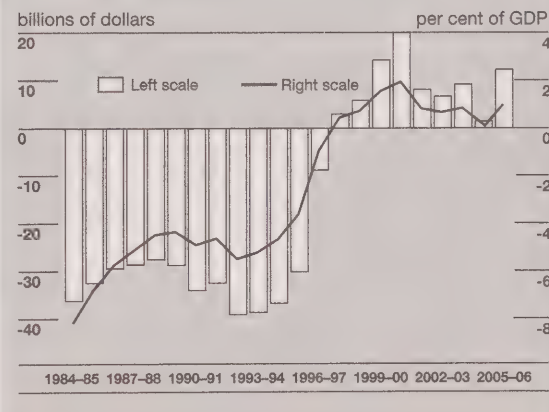
- A budgetary surplus of $13.2 billion was achieved in 2005–06. As a result of the surplus, the federal debt is down $561 for each Canadian.
- Federal debt stood at $481.5 billion at the end of 2005–06, down $81.4 billion from its peak of $562.9 billion in 1996–97. The federal debt-to-GDP (gross domestic product) ratio is 35.1 per cent, down sharply from its peak of 68.4 per cent in 1995–96.
- Unmatured debt—the debt issued on credit markets to investors—as a percentage of GDP has declined to 30.7 per cent from the peak of 57.7 per cent in 1995–96.
- The revenue-to-GDP ratio in 2005–06 was 16.2 per cent, down from 16.4 per cent in 2004–05, reflecting tax cuts implemented in 2005.
- Program expenses were down $1.1 billion over the prior year, marking the first year-over-year decline since 1996–97. The program expense-to-GDP ratio decreased to 12.8 per cent in 2005–06 from 13.7 per cent in 2004–05.
- Public debt charges declined by $0.3 billion in 2005–06. As a percentage of revenues, public debt charges were 15.2 per cent in 2005–06, down from a peak of about 38 per cent in 1990–91. The share of revenues devoted to public debt charges is now at its lowest level since the late 1970s.
- The 2005–06 surplus was $5.2 billion higher than the $8-billion surplus forecast in the May 2006 budget. The increase in the 2005–06 surplus compared to the May 2006 budget was largely attributable to lower than expected program expenses. Of the $5.2-billion difference between the 2005–06 surplus estimated in the 2006 budget and the final audited results, $3.5 billion resulted from year-end accrual adjustments.

The Budgetary Balance

A budgetary surplus of $13.2 billion was recorded in 2005–06. Budgetary revenues increased by $10.3 billion, or 4.8 per cent, over 2004–05, reflecting strong growth in the economy and the applicable tax bases. Public debt charges declined by $0.3 billion, or 1.0 per cent, due to a decline in the stock of interest-bearing debt. Program expenses decreased by $1.1 billion, or 0.7 per cent, due to a number of one-time expenses which boosted spending in 2004–05, as well as developments in 2005–06 which reduced spending, most notably the dissolution of Parliament in November 2005 and the change in government. This marks the first year-over-year decrease in federal program expenses in nine years.

To enhance the comparability of financial results over time and across jurisdictions, the budgetary balance and its components are often presented as a percentage of GDP.

Budgetary Balance



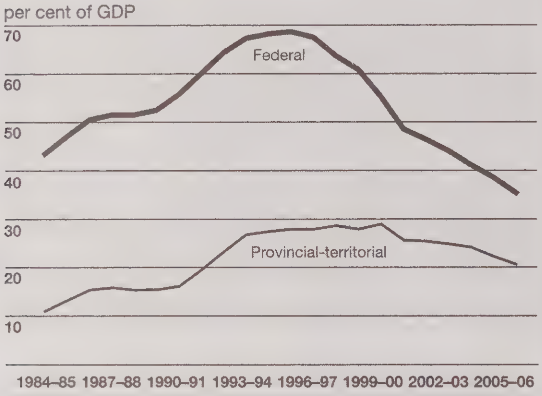
Sources: *Public Accounts of Canada* and Statistics Canada.

Table 1
Budgetary Revenues and Expenses

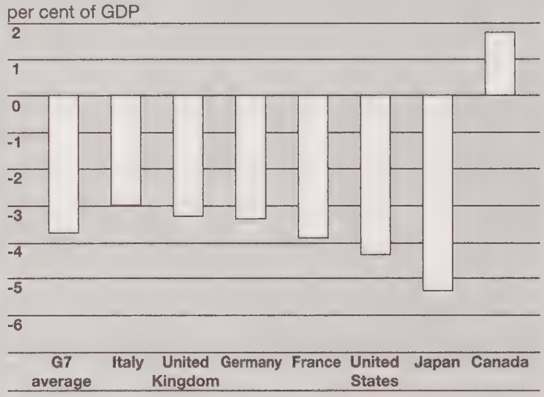
	2004–05	2005–06	Change[1]
		(per cent of GDP)	
Budgetary revenues	16.4	16.2	-0.2
Program expenses	13.7	12.8	0.9
Public debt charges	2.6	2.5	0.2
Budgetary balance	**0.1**	**1.0**	**0.9**

[1] A negative number indicates a deterioration in the balance. A positive number indicates an improvement in the balance.
Note: Numbers may not add due to rounding.

Federal Debt and Provincial-Territorial Debt



Total Government Financial Balances[1] (2005)



[1] The OECD uses the term "financial balance" to mean budgetary balance.

The budgetary surplus as a percentage of GDP increased from 0.1 per cent in 2004–05 to 1.0 per cent in 2005–06. The fiscal improvement is attributable to a decline in the program expense to GDP ratio, which fell from 13.7 per cent to 12.8 per cent (Table 1). Public debt charges as a percentage of GDP fell from 2.6 per cent in 2004–05 to 2.5 per cent in 2005–06.

The change in program expenses as a percentage of GDP was due to a number of one-time expenses recorded in 2004–05, as well as the dissolution of Parliament in November 2005 and the change in government. The decline in public debt charges as a percentage of GDP was attributable to a decline in interest-bearing debt.

Budgetary revenues as a percentage of GDP fell from 16.4 per cent in 2004–05 to 16.2 per cent in 2005–06, reflecting $5.0 billion in personal income tax reductions that came into effect in 2005–06.

In 2005–06, the provinces and territories continued to improve their fiscal situation due to strong revenue growth, particularly from natural resource royalties and personal and corporate income taxes. The aggregate provincial-territorial surplus is currently estimated at $13.2 billion[1] for 2005–06, up from the $6.5-billion aggregate surplus posted in 2004–05.

[1] Based on final results for New Brunswick, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia and 2006 budget estimates for the remaining provinces.

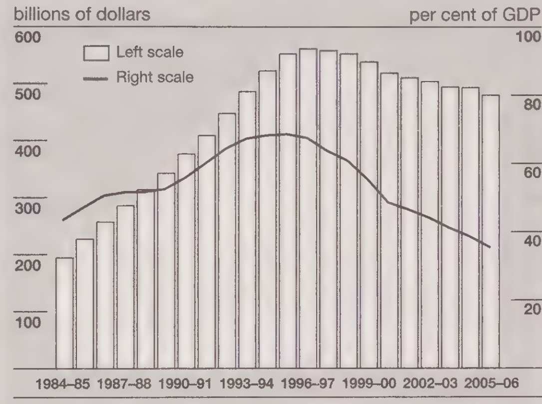
As a result of improving budgetary balances and economic growth in recent years, both federal and provincial-territorial debts have declined as a share of GDP, with the federal debt ratio falling more dramatically. However, federal debt as a share of GDP still exceeds that of most provinces and remains significantly higher than the provincial average. Lower debt-to-GDP ratios, combined with lower interest rates and improved credit ratings, have enabled both orders of government to allocate a smaller portion of revenues to debt interest payments and a greater portion to program expenditures, tax reductions and debt repayment.

According to Organisation for Economic Co-operation and Development (OECD) estimates for the total government sector,[2] Canada was the only Group of Seven (G7) country to record a surplus in calendar year 2005. Canada's surplus for 2005 is estimated at 1.7 per cent of GDP, compared to an average deficit of 3.7 per cent in the G7 countries. Moreover, Canada is expected to continue to be the only G7 country to post a total government surplus again in 2006 and 2007.

Federal Debt

The 2005–06 surplus of $13.2 billion brings federal debt—the accumulation of annual deficits and surpluses since Confederation—down to $481.5 billion. Federal debt has declined by $81.4 billion from its peak of $562.9 billion in 1996–97. As a share of GDP, it dropped to 35.1 per cent in 2005–06, down from the peak of 68.4 per cent in 1995–96, bringing it to its lowest level since 1981–82. Federal debt at the end of 2005–06 was $14,815 for each Canadian, down from $15,376 a year earlier.

Federal Debt (Accumulated Deficit)



Sources: *Public Accounts of Canada* and Statistics Canada.

Federal Debt (Accumulated Deficit)

Since 2002–03, the financial statements of the Government of Canada are presented on a full accrual basis of accounting. Under the previous accounting standard—modified accrual accounting—net debt and the accumulated deficit were identical. Under the new standard, net debt now includes a comprehensive costing for financial liabilities but excludes non-financial assets. The accumulated deficit includes both. It is the sum of all surpluses and deficits in the past.

Federal debt, referred to in the budget documents and the *Annual Financial Report of the Government of Canada*, is the accumulated deficit. It is the federal government's main measure of debt, as annual changes in this measure correspond to the budgetary balance.

[2] Includes federal, provincial-territorial and local governments as well as the Canada Pension Plan and Quebec Pension Plan.

Table 2
Financial Highlights

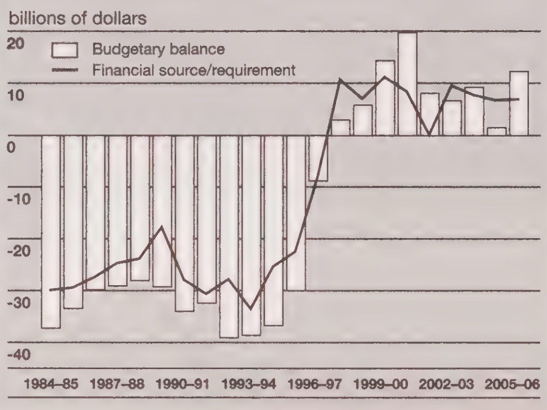
	2004–05	2005-06
	($ billions)	
Budgetary transactions		
Revenues	211.9	222.2
Expenses		
Program expenses	-176.4	-175.2
Public debt charges	- 34.1	-33.8
Total expenses	-210.5	-209.0
Budgetary balance	**1.5**	**13.2**
Non-budgetary transactions	5.1	-6.4
Financial source/requirement	6.6	6.8
Net change in financing activities	-6.6	-6.3
Net change in cash balances	0.0	0.5
Cash balance at end of period	20.6	21.1
Financial position		
Total liabilities	705.0	702.5
Total financial assets	155.4	165.6
Net debt	549.6	536.9
Non-financial assets	54.9	55.4
Federal debt (accumulated deficit)	**494.7**	**481.5**
Financial results (% of GDP)		
Budgetary revenues	16.4	16.2
Program expenses	13.7	12.8
Public debt charges	2.6	2.5
Budgetary balance	0.1	1.0
Federal debt (accumulated deficit)	38.3	35.1

Note: Numbers may not add due to rounding.

Financial Source/Requirement

The financial source/requirement measures the difference between cash coming in to the Government and cash going out. There was a financial source of $6.8 billion in 2005–06, compared to a financial source of $6.6 billion in 2004–05.

Budgetary Balance and Financial Source/Requirement



Sources: *Public Accounts of Canada* and Statistics Canada.

Budgetary Revenues

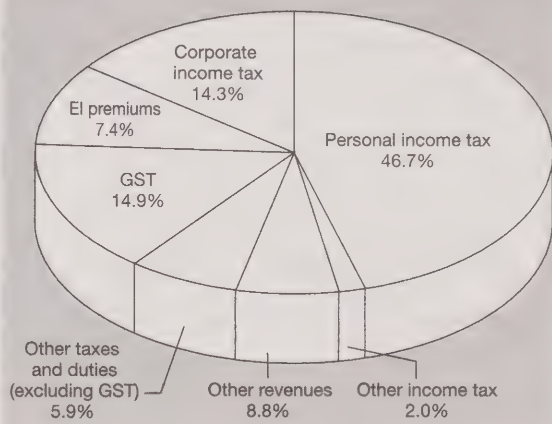
Budgetary revenues were $222.2 billion in 2005–06, an increase of $10.3 billion, or 4.8 per cent, from 2004–05 (Table 3). Tax revenues rose by $11.2 billion, or 6.4 per cent, while employment insurance (EI) premium revenues fell by $0.8 billion, or 4.5 per cent. Other revenues decreased by $0.2 billion, or 0.9 per cent. Total budgetary revenues were $1.3 billion, or 0.6 per cent, higher than estimated in the May 2006 budget. Excluding the impact of a change in the Government's accounting treatment of subscriptions in the International Monetary Fund (IMF), revenues increased by $0.3 billion over the Budget 2006 estimate.

The largest source of budgetary revenues in 2005–06 was personal income tax revenues, which stood at 46.7 per cent of budgetary revenues. The second largest source was goods and services tax (GST) revenues, at 14.9 per cent. Corporate income tax revenues were 14.3 per cent of budgetary revenues, up 8.6 percentage points from a low of 5.7 per cent in 1992–93. EI premium revenues contributed to 7.4 per cent of revenues.

Personal income tax revenues increased by $5.2 billion, or 5.2 per cent, in 2005–06. Taking into account the $5.0 billion in tax reduction measures pertaining to 2005–06, the underlying growth in personal income tax revenues was over 10 per cent, well above the 5.8-per-cent increase in personal income in the same period. The difference in growth rates reflects a number of factors, including the interaction of strong real income gains with the progressivity of the personal income tax system and the fact that personal income, as measured in the National Income and Expenditure Accounts, excludes some components of taxable income, such as pension income and capital gains.

Corporate income tax revenues were $1.8 billion, or 5.9 per cent, higher in 2005–06 than in 2004–05. This gain was lower than the 10.6-per-cent growth in corporate profits in 2005, reflecting in part the ongoing implementation of tax measures. Other income tax revenues—largely withholding taxes levied on non-residents—were $1.0 billion, or 27.2 per cent, higher in 2005–06 than in the previous year, reflecting strong growth in dividend payments to non-residents recorded in the latter months of 2005.

Composition of Revenues for 2005–06



Source: *Public Accounts of Canada.*

Other taxes and duties increased by $3.3 billion, or 7.7 per cent, in 2005–06, primarily due to higher GST revenues, which were up $3.3 billion, or 11.0 per cent. Growth in GST revenues was significantly higher than growth in the applicable tax base. In recent years, there has been substantial variation between growth in GST revenues and growth in the underlying tax base, with GST revenue growth exceeding growth in the tax base in some years, as in 2005–06, and falling short of growth in the tax base in other years. The $0.2-billion, or 4.2-per-cent, decline in other excise taxes and duties principally reflects declining revenues from tobacco duties.

EI premium revenues declined by $0.8 billion, or 4.5 per cent, from the previous year, reflecting reductions in premium rates, which more than offset the impact of higher employment and wages and salaries. The decline also reflects the implementation of the Quebec Parental Insurance Plan in January 2006, under which the responsibility for delivering parental benefits in Quebec, along with collection of the associated premium revenues, was transferred to the Province of Quebec.

Table 3
Revenues

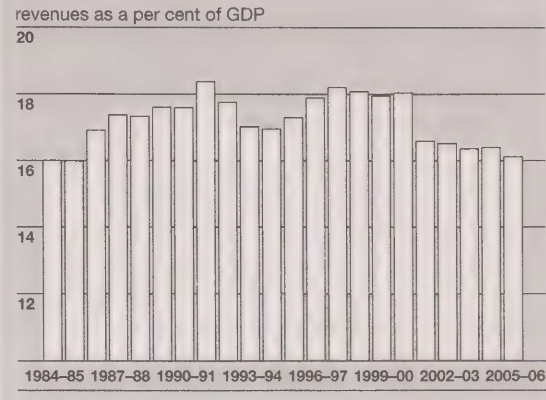
	2004–05	2005–06	Net change	
		($ millions)		(%)
Tax revenues				
Income tax				
Personal income tax	98,521	103,691	5,170	5.2
Corporate income tax	29,956	31,724	1,768	5.9
Other income tax	3,560	4,529	969	27.2
Total	132,037	139,944	7,907	6.0
Other taxes and duties				
Goods and services tax	29,758	33,020	3,262	11.0
Energy taxes	5,054	5,076	22	0.4
Customs import duties	3,091	3,330	239	7.7
Air Travellers Security Charge	383	353	-30	-7.8
Other excise taxes and duties	4,571	4,377	-194	-4.2
Total	42,857	46,156	3,299	7.7
Total tax revenues	**174,894**	**186,100**	**11,206**	**6.4**
Employment insurance premium revenues	17,307	16,535	-772	-4.5
Other revenues				
Crown corporation revenues	6,825	7,198	373	5.5
Foreign exchange revenues	1,175	2,014	839	71.4
Other program revenues	11,742	10,356	-1,386	-11.8
Total	19,742	19,568	-174	-0.9
Total revenues	**211,943**	**222,203**	**10,260**	**4.8**

Note: Numbers may not add due to rounding.

Other revenues consist of revenues from Crown corporations, such as the Bank of Canada, Export Development Canada and Canada Mortgage and Housing Corporation; foreign exchange revenues; and other program revenues, primarily revenues from the sales of goods and services. Other revenues were down $0.2 billion, or 0.9 per cent, in 2005–06. After adjusting for the one-time $2.6-billion gain the Government realized by selling its remaining shares in Petro-Canada in 2004–05, other revenues rose by $2.4 billion in 2005–06. Of the $2.4-billion increase in other revenues, $1.0 billion relates to a one-time adjustment recorded in 2005–06 resulting from a change in the Government's accounting treatment of Canada's subscriptions in the IMF. This change was made during the year-end process of preparing the financial statements, and after discussions with the Auditor General, to reflect the impact of currency fluctuations in a more timely manner. The remaining increase in other revenues reflects growth in Crown corporation revenues and other program revenues, including sales of goods and services and return on investments.

The revenue ratio—budgetary revenues as a percentage of GDP—represents an approximate measure of the overall federal tax burden in that it compares the total of all federal revenues to the size of the economy. The revenue ratio stood at 16.2 per cent in 2005–06, down from 16.4 per cent in 2004–05. This decline was primarily due to tax reduction measures in 2005, including a drop in the lowest personal income tax rate, an increase in the basic personal amount and a reduction in the federal capital tax rate.

Revenue Ratio



Sources: Department of Finance and Statistics Canada.

Total Expenses

Total expenses consist of program expenses and public debt charges. In 2005–06 total expenses amounted to $209.0 billion, down $1.5 billion, or 0.7 per cent, from 2004–05.

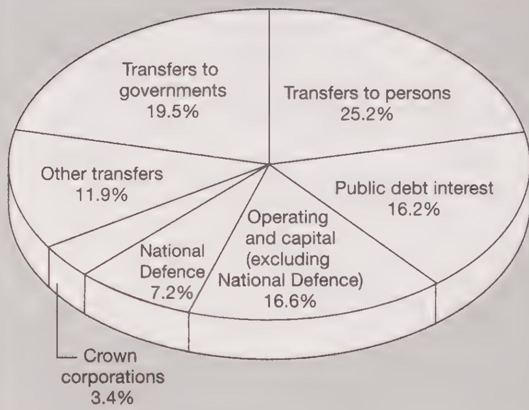
Major transfers to persons (elderly benefits, EI benefits and the Canada Child Tax Benefit) and major transfers to other levels of government (the Canada Health Transfer, the Canada Social Transfer, fiscal arrangements and Alternative Payments for Standing Programs) are the two largest components of total expenses, representing 25.2 and 19.5 per cent of expenses, respectively. Other transfers made by various federal departments to individuals, businesses and other organizations and groups made up 11.9 per cent of total expenses in 2005–06.

After transfers, the next largest component of total expenses was operating costs of government departments and agencies, excluding National Defence, at 16.6 per cent. Operating costs include items such as salaries and benefits, facilities and equipment, and supplies and travel.

Public debt charges amounted to 16.2 per cent of total expenses in 2005–06. This is down from a peak of nearly 30 per cent in the mid-1990s, when it was the largest component of expenses, reflecting the large stock of interest-bearing debt and high average effective interest rates on that stock. With the reductions in interest-bearing debt and lower interest rates, its share of total expenses has fallen over 13 percentage points from a high of 29.8 per cent in 1996–97.

Program expenses amounted to $175.2 billion in 2005–06, a decrease of $1.1 billion, or 0.7 per cent, from 2004–05 (Table 4). This marks the first year-over-year decline in nine years. The decrease was due to a number of one-time expenses recorded in 2004–05 as well as developments in 2005–06, most notably the dissolution of Parliament in November 2005 and the change in government.

Composition of Expenses for 2005–06



Source: *Public Accounts of Canada.*

Within program expenses, transfer payments decreased by $0.4 billion, while Crown corporation expenses decreased by $1.7 billion. These decreases were partially offset by a modest increase in the operating expenses of National Defence and other departments and agencies.

Public debt charges declined by $0.3 billion, or 1.0 per cent.

Table 4

Total Expenses

	2004–05	2005–06	Net change	
		($ millions)		(%)
Transfers payments				
Major transfers to persons				
Elderly benefits	27,871	28,992	1,121	4.0
Employment insurance benefits	14,748	14,417	-331	-2.2
Canada Child Tax Benefit	8,688	9,200	512	5.9
Total	51,307	52,609	1,302	2.5
Major transfers to other levels of government				
Support for health and other social programs	23,081	27,225	4,144	18.0
Wait Times Reduction Fund	4,250		-4,250	
Medical Equipment Fund	500		-500	
Early learning and child care	700		-700	
Bill C-48		3,300	3,300	
Fiscal arrangements and other transfers	13,340	13,021	-319	-2.4
Offshore Revenues Accords	2,830		-2,830	
Alternative Payments for Standing Programs	-2,746	-2,731	15	-0.5
Total	41,955	40,815	-1,140	-2.7
Direct program expenses				
Subsidies and other transfers[1]	25,453	24,893	-560	-2.2
Other program expenses				
Crown corporations				
Canada Mortgage and Housing Corporation	2,072	2,119	48	2.3
Canadian Broadcasting Corporation	1,714	1,705	-9	-0.5
Other cultural agencies	700	668	-31	-4.5
Canadian Air Transport Security Authority	295	349	54	18.3
Other	4,127	2,354	-1,773	-43.0
Total	8,907	7,195	-1,712	-19.2
National Defence	14,318	15,034	716	5.0
All other departments and agencies	34,422	34,667	245	0.7
Total other program expenses	57,647	56,896	-751	-1.3
Total direct program expenses	83,100	81,789	-1,311	-1.6
Total program expenses	**176,362**	**175,213**	**-1,149**	**-0.7**
Public debt charges	34,118	33,772	-346	-1.0
Total expenses	**210,480**	**208,985**	**-1,495**	**-0.7**

[1] See Table 5 for details.

Note: Numbers may not add due to rounding.

Major transfers to persons increased by $1.3 billion, or 2.5 per cent.

- Elderly benefits consist of Old Age Security, Guaranteed Income Supplement and Allowance payments. Total benefits were up $1.1 billion, or 4.0 per cent, in 2005–06, reflecting both higher average benefits, which are indexed to inflation, and an increase in the number of recipients.
- EI benefits consist of regular benefits, special benefits (sickness, maternity, parental, adoption and fishing) and labour market adjustment benefits. Total benefits decreased by $0.3 billion in 2005–06 due to a decline in regular benefits, in line with improvements in the labour market.
- The Canada Child Tax Benefit consists of the base benefit, the National Child Benefit (NCB) supplement and the Child Disability Benefit. These benefits increased by 5.9 per cent in 2005–06, from $8.7 billion in 2004–05 to $9.2 billion in 2005–06, primarily due to an increase in the NCB supplement in July 2005.

Major transfers to other levels of government include the Canada Health Transfer (CHT), the Canada Social Transfer (CST), fiscal arrangements (equalization, transfers to the territories, as well as a number of smaller transfer programs), and Alternative Payments for Standing Programs. Transfers decreased by $1.1 billion, or 2.7 per cent, in 2005–06, following an increase of $12.6 billion, or 42.7 per cent, in 2004–05. The decline in 2005–06 reflects a number of one-time transfers to the provinces and territories in 2004–05, including $4.3 billion for the Wait Times Reduction Fund, $2.8 billion for the Offshore Revenues Accords, $700 million for early learning and child care and $500 million for medical equipment.

- The CHT and CST—block-funded transfers—support health care, post-secondary education, social assistance and social services, including early childhood development. They provide support in the form of cash and tax transfers to the provinces and territories. These transfers in support of health and other social programs increased by $4.1 billion in 2005–06, reflecting legislated increases in the CHT and the CST in 2005–06.
- Total entitlements under fiscal arrangements and other transfers decreased by $0.3 billion to $13.0 billion in 2005–06.
- Bill C-48, An Act to authorize the Minister of Finance to make certain payments, authorizes the Minister of Finance to make payments for specified purposes, totalling no more than $4.5 billion, from any surplus above $2 billion in 2005–06 and/or 2006–07. The Government expensed $3.3 billion in transfers to provinces and territories for post-secondary education, public transit and affordable housing under this authority in 2005–06. An additional $320 million in foreign assistance was expensed under Bill C-48 in 2005–06 and is included in subsidies and other transfers.
- Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allow provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provides provinces with tax points, the value of which are netted against total entitlements and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Subsidies and other transfers decreased by $0.6 billion, or 2.2 per cent, in 2005–06, reflecting fairly broad-based declines across departments (Table 5).

Table 5
Subsidies and Other Transfers

	2004–05	2005–06	Net change	
		($ millions)		(%)
Agriculture and Agri-Food				
BSE recovery program	1,488	33	-1,455	-97.8
Grains and Oilseeds Payment Program	0	756	756	
Other	1,264	1,806	542	42.9
Total	2,752	2,595	-157	-5.7
Foreign Affairs and International Trade	3,408	3,357	-51	-1.5
Health Canada				
First Nations and Inuit health	779	857	77	9.9
Canadian Institutes of Health Research	705	758	53	7.6
Primary Health Care Transition Fund	211	185	-26	-12.3
Other	381	281	-101	-26.4
Total	2,076	2,080	4	0.2
Human Resources and Skills Development				
Student assistance programs	759	848	89	11.8
Labour market programs	500	526	26	5.2
Energy Cost Benefit	0	210	210	
Other	358	609	251	70.2
Total	1,616	2,193	577	35.7
Indian and Northern Affairs	4,934	5,401	468	9.5
Industry/regional agencies/granting councils				
Technology Partnerships Canada	304	284	-20	-6.6
Infrastructure Canada	398	368	-30	-7.5
Regional agencies	563	537	-26	-4.5
Natural Sciences and Engineering Research Council of Canada/Social Sciences and Humanities Research Council of Canada	1,263	1,371	107	8.5
Other	377	434	56	15.0
Total	2,905	2,994	88	3.0
Genome Canada	225	0	-225	-100.0
Green Municipal Fund	300	0	-300	-100.0
Other	7,236	6,272	-964	-13.3
Total	**25,453**	**24,893**	**-560**	**-2.2**

Note: Numbers may not add due to rounding.

Other program expenses—total program expenses less transfers—consist of the operating costs of government: the more than 130 departments, agencies, Crown corporations and other federal bodies that deliver programs and services to Canadians. These expenses amounted to $56.9 billion in 2005–06, down $0.8 billion, or 1.3 per cent, from 2004–05. Within this component:

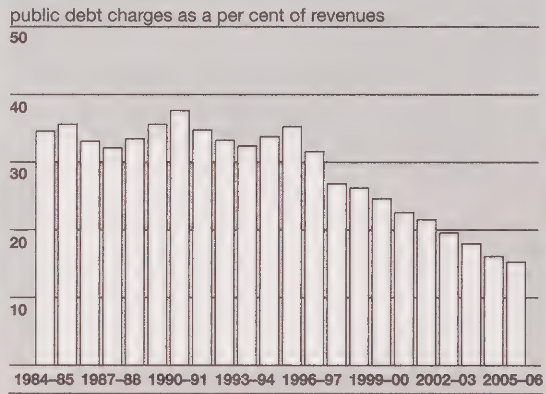
- Crown corporation expenses fell $1.7 billion to $7.2 billion in 2005–06, mainly due to a one-time $2.3-billion expense recorded by Atomic Energy of Canada Limited for environmental liabilities in 2004–05.
- Defence expenses increased by $0.7 billion, or 5.0 per cent, primarily reflecting incremental annual resources to strengthen Canada's military.
- All other departmental and agency expenses increased by $0.2 billion, or 0.7 per cent, due to growth in operating costs.

Public debt charges declined by $0.3 billion, or 1.0 per cent, to $33.8 billion in 2005–06, reflecting the impact of a decline in the stock of interest-bearing debt.

- The average effective interest rate on the Government's interest-bearing debt (unmatured debt and pension and other accounts) was 5.6 per cent in 2005–06, unchanged from 2004–05. The average effective interest rate was 5.0 per cent on unmatured debt (5.0 per cent in 2004–05); in contrast, the average effective interest rate on pension and other accounts was 6.9 per cent (6.9 per cent in 2004–05).
- The stock of total interest-bearing debt decreased by $6.2 billion, from $607.2 billion in 2004–05 to $601.1 billion in 2005–06. The stock of unmatured debt declined by $6.3 billion to $421.1 billion, while liabilities for pension and other accounts increased by $0.1 billion to $179.9 billion.

The interest ratio—public debt charges as a percentage of budgetary revenues—declined from 16.1 per cent in 2004–05 to 15.2 per cent in 2005–06. This ratio means that, in 2005–06, the Government spent just over 15 cents of every revenue dollar on interest on the public debt. This is down from the peak of about 38 cents in 1990–91 and is the lowest this ratio has been since the late 1970s. This is money that must be paid to meet the Government's ongoing obligations on its debt. The lower the ratio, the more flexibility the Government has to address the key priorities of Canadians.

Interest Ratio



Source: Department of Finance.

The Budgetary Balance and Financial Source/Requirement

The budgetary balance is the most comprehensive measure of the federal government's fiscal results. It is presented on a full accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made, and recording tax revenues when earned, regardless of when the cash is received.

In contrast, the financial source/requirement measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance in that it includes cash transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, foreign exchange activities, and changes in other financial assets, liabilities and non-financial assets. These activities are included as part of non-budgetary transactions. The conversion from full accrual to cash accounting is also reflected in non-budgetary transactions.

Non-budgetary transactions in 2005–06 resulted in a net requirement of funds amounting to $6.4 billion, compared to a source of $5.1 billion in 2004–05. This turnaround largely reflects a change in the timing of the recognition and settlement of liabilities over the two years. In 2005–06, significant payments were made to settle liabilities recorded in 2004–05, including transfers under the Offshore Revenues Accords and the Wait Times Reduction Fund.

With a budgetary surplus of $13.2 billion and a net requirement from non-budgetary transactions of $6.4 billion, there was a financial source of $6.8 billion in 2005–06, up $0.2 billion from the $6.6-billion source posted in 2004–05 (Table 6).

With this financial source, the Government retired $6.3 billion of its unmatured debt and increased its cash balances by $0.5 billion. Cash balances at March 31, 2006, stood at $21.1 billion.

Table 6

Budgetary Balance, Financial Source/Requirement and Net Financing Activities

	2004–05	2005–06
	($ billions)	
Surplus for the year	**1.5**	**13.2**
Non-budgetary transactions		
Pension and other accounts		
Public sector pensions	2.0	1.5
Canada Pension Plan	-4.7	-2.6
Other	1.6	1.3
Total	-1.1	0.1
Capital investing activities	-3.7	-4.5
Other investing activities	-4.4	-3.7
Other activities		
Accounts payable, receivable, accruals and allowances	7.2	-2.3
Foreign exchange activities	3.4	0.0
Amortization of tangible capital assets	3.7	3.9
Total other activities	14.3	1.7
Total non-budgetary transactions	5.1	-6.4
Financial source/requirement	**6.6**	**6.8**
Net change in financing activities		
Marketable bonds	-12.0	-4.7
Treasury bills	13.8	4.4
Canada Savings Bonds	-2.3	-1.7
Other	-6.1	-4.3
Total	-6.6	-6.3
Change in cash balances	0.0	0.5
Cash at end of year	**20.6**	**21.1**

Note: Numbers may not add due to rounding.

Federal Debt

Total liabilities consist of interest-bearing debt and accounts payable and accrued liabilities. Interest-bearing debt includes unmatured debt and liabilities for pension and other accounts. At March 31, 2006, interest-bearing debt amounted to $601.1 billion, down $6.2 billion from a year earlier (Table 7). Accounts payable and accrued liabilities amounted to $101.4 billion, up $3.7 billion from 2004–05. As a result, total liabilities at March 31, 2006 stood at $702.5 billion, down $2.5 billion from the previous year.

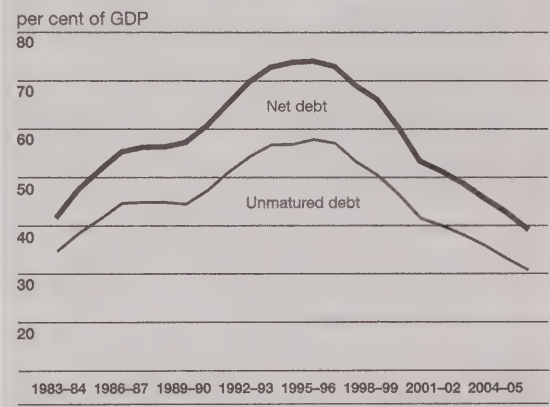
Financial assets consist of cash and accounts receivable (including tax receivables), foreign exchange accounts and loans, investments and advances. Financial assets totalled $165.6 billion at March 31, 2006, up $10.2 billion from March 31, 2005. Increases were recorded in cash and accounts receivable (up $6.5 billion) and in loans, investments and advances (up $3.7 billion), while net assets in foreign exchange accounts declined by $44 million. As a result, net debt stood at $536.9 billion at March 31, 2006, down $12.6 billion from March 31, 2005, and $72.1 billion below the peak of $609 billion at March 31, 1997. As a per cent of GDP, net debt dropped to 39.2 per cent in 2005–06, down 34.7 percentage points from its peak of 73.9 per cent in 1995–96. This is the 10th consecutive year in which the net debt-to-GDP ratio has declined.

Non-financial assets, consisting of tangible capital assets, inventories and prepaid expenses, amounted to $55.4 billion at March 31, 2006, up $0.6 billion from March 31, 2005.

With total liabilities of $702.5 billion, financial assets of $165.6 billion and non-financial assets of $55.4 billion, the federal debt (accumulated deficit) stood at $481.5 billion at March 31, 2006, down $13.2 billion from 2004–05 and $81.4 billion from its peak in 1996–97. The decline in federal debt between 2004–05 and 2005–06 was largely attributable to an increase in financial assets and a decrease in interest-bearing debt.

Both net debt and unmatured debt, expressed as a percentage of GDP, are now below 1983–84 levels.[3]

Net Debt and Unmatured Debt



Source: Department of Finance.

[3] Due to a break in the series following the introduction of full accrual accounting, data from 1983–84 are not directly comparable with earlier years.

Table 7

Outstanding Debt at Year-End

	2004–05	2005–06
	($ billions)	
Liabilities		
Accounts payable and accrued liabilities	97.7	101.4
Interest-bearing debt		
Unmatured debt	427.4	421.1
Pension and other accounts	179.8	179.9
Total	607.2	601.1
Total liabilities	705.0	702.5
Financial assets		
Cash and accounts receivable	76.3	82.8
Foreign exchange accounts	40.9	40.8
Loans, investments and advances	38.2	41.9
Total financial assets	155.4	165.6
Net debt	**549.6**	**536.9**
Non-financial assets		
Tangible capital assets	48.2	48.4
Inventories	5.5	5.9
Prepaid expenses	1.1	1.2
Total non-financial assets	54.9	55.4
Federal debt (accumulated deficit)	**494.7**	**481.5**

Note: Numbers may not add due to rounding.

Comparison of Actual Budgetary Outcomes to Budget Estimates

This section compares the actual outcome for the major components of the budgetary balance for 2005–06 to the estimates presented in the May 2006 budget. The Government estimated a surplus of $8.0 billion for 2005–06 in the May 2006 budget. This amount was allocated to planned federal debt reduction. The final audited budgetary surplus for 2005–06 is $13.2 billion.

The increase in the 2005–06 surplus compared to the May 2006 budget was largely attributable to lower than expected program expenses, which were $3.9 billion lower than forecast in the budget. The estimate of other program expenses set out in the May 2006 budget was based on monthly financial information through February 2006. Traditionally, a significant amount of spending occurs in March. In addition, substantial adjustments are required in the end-of-year supplementary period to incorporate the cost of liabilities incurred during the fiscal year for which no payments were made, as well as new information based on tax assessments that are carried out in the March-to-May period. The difference between actual program expenses and the budget forecast was largely due to lower than expected departmental spending and accrual adjustments.

Within program expenses, elderly benefits were marginally lower than expected ($0.1 billion), while the Canada Child Tax Benefit was $0.1 billion higher than expected. Major transfers to other levels of government were $0.1 billion higher than expected.

Of the $3.9-billion difference between actual program expenses and the budget forecast, $1.4 billion was due to lower year-end spending by departments and Crown corporations. A further $1.5 billion was attributable to year-end accrual adjustments to reflect an increase in the estimated creditworthiness of debt owed to the Government, while the remaining $1.0 billion was attributable to year-end accrual adjustments for valuation allowances and provisions for liabilities, including liabilities for pensions and other employee future benefits.

Public debt charges were $52 million higher than estimated.

Budgetary revenues were $1.3 billion higher than projected in the budget, as lower than projected corporate income tax revenues were more than offset by other components of revenue that were higher than projected, particularly GST and non-tax revenues. Corporate income tax revenues were $2.8 billion lower than projected, as revenues rose significantly less than profits across a number of sectors. Non-tax revenues (excluding EI premium revenues) were $3.0 billion higher than projected in the budget, reflecting a $1.0-billion one-time increase in other revenues resulting from a change in the accounting treatment of the Government's subscriptions in the IMF; stronger than expected revenues from Crown corporations; and higher than expected other non-tax revenues. Excise taxes and duties were $0.8 billion higher than projected, primarily reflecting stronger than expected growth in GST revenues.

Taken together, year-end accrual adjustments account for $3.5 billion of the $5.2-billion difference between the 2005–06 surplus estimated in the May 2006 budget and the final audited outcome.

Table 8
Comparison of Actual Outcomes to May 2006 Budget

	Actual	2006 budget	Difference
		($ billions)	
Budgetary revenues			
Personal income tax	103.7	103.0	0.7
Corporate income tax	31.7	34.5	-2.8
Other income tax	4.5	4.6	-0.1
Excise taxes and duties	46.2	45.3	0.8
Employment insurance premium revenues	16.5	16.9	-0.3
Other revenues	19.6[1]	16.5	3.0
Total	222.2	220.9	1.3
Program expenses			
Major transfers to persons			
Elderly benefits	29.0	29.1	-0.1
Employment insurance benefits	14.4	14.4	0.0
Canada Child Tax Benefit	9.2	9.1	0.1
Total	52.6	52.7	-0.1
Major transfers to other levels of government			
Support for health and other social programs	27.2	27.2	0.0
Fiscal arrangements	12.4	12.4	0.1
Bill C-48	3.3	3.3	0.0
Alternative Payments for Standing Programs	-2.7	-2.7	0.0
Canada's cities and communities	0.6	0.6	0.0
Total	40.8	40.8	0.1
All other expenses	81.8	85.7	-3.9
Total	175.2	179.2	-3.9
Public debt charges	33.8	33.7	0.1
Budgetary outcome/estimate	**13.2**	**8.0**	**5.2**

[1] Includes revenues from Crown corporations, foreign exchange revenues, including the $1.0-billion adjustment recorded in 2005–06 to reflect a change in the Government's accounting treatment of Canada's subscriptions in the IMF, and other program revenues.
Note: Numbers may not add due to rounding.

Auditor General of Canada
Vérificatrice générale du Canada

Report of the Auditor General on the Condensed Financial Statements of the Government of Canada

To the Minister of Finance:

The accompanying condensed statements of operations and accumulated deficit, financial position, change in net debt and cash flow are derived from the complete financial statements of the Government of Canada as at March 31, 2006, and for the year then ended on which I expressed an opinion without reservation in my Report to the House of Commons dated August 24, 2006.

For more complete information, readers should refer to my Report, which will be included in Volume I of the *Public Accounts of Canada 2006*, expected to be tabled in the House of Commons later this year.

The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility, in accordance with the applicable Assurance Guideline of The Canadian Institute of Chartered Accountants, is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria described in the Guideline referred to above.

Since these are condensed financial statements, readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's results of operations and accumulated deficit, financial position, change in net debt and cash flow, reference should be made to the related complete financial statements, which will also be included in Volume I of the *Public Accounts of Canada 2006*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
August 24, 2006

Condensed Financial Statements of the Government of Canada

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs and resources for which the Government is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the Government.

These financial statements are extracted and condensed from the audited financial statements included in Section 2 of Volume I of the *Public Accounts of Canada 2006*, which are expected to be tabled in Parliament later this year.

As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 9

Government of Canada
Condensed Statement of Operations and Accumulated Deficit for the Year Ended March 31, 2006

	2006		Restated (Note 2) 2005
	Budget[1]	Actual	Actual
		($ millions)	
Revenues			
Income tax	136,100	139,944	132,037
Other taxes and duties	45,000	46,156	42,857
Employment insurance premiums	17,200	16,535	17,307
Other revenues	16,000	19,568	19,742
Total revenues	***214,300***	***222,203***	***211,943***
Expenses			
Transfer payments			
Old age security and related payments	29,100	28,992	27,871
Other levels of government	37,500	40,815	41,955
Employment insurance benefits	15,700	14,417	14,748
Other transfer payments	35,800	34,093	34,141
Total transfer payments	*118,100*	*118,317*	*118,715*
Other program expenses	57,100	56,896	57,647
Total program expenses	***175,200***	***175,213***	***176,362***
Public debt charges	35,100	33,772	34,118
Total expenses	***210,300***	***208,985***	***210,480***
Annual surplus	**4,000**[2]	**13,218**	**1,463**
Accumulated deficit, beginning of year	494,700[3]	494,717	496,180
Accumulated deficit, end of year	**490,700**	**481,499**	**494,717**

[1] Derived from Budget 2005 and adjusted to a gross basis.

[2] Budget 2005 disclosed the budgetary surplus as $4 billion before deducting reserves for contingency ($3 billion) and economic prudence ($1 billion).

[3] Adjusted to the actual closing amount of previous year.

Table 10

Government of Canada
Condensed Statement of Financial Position
as at March 31, 2006

	2006	Restated (Note 2) 2005
	($ millions)	
Liabilities		
Accounts payable and accrued liabilities	101,432	97,740
Interest-bearing debt		
Unmatured debt	421,149	427,424
Pension and other liabilities	179,924	179,808
Total interest-bearing debt	*601,073*	*607,232*
Total liabilities	***702,505***	***704,972***
Financial assets		
Cash and accounts receivable	82,843	76,346
Foreign exchange accounts	40,827	40,871
Loans, investments and advances	41,889	38,168
Total financial assets	***165,559***	***155,385***
Net debt	***536,946***	***549,587***
Non-financial assets		
Tangible capital assets	48,355	48,210
Other	7,092	6,660
Total non-financial assets	***55,447***	***54,870***
Accumulated deficit	**481,499**	**494,717**

Table 11

Government of Canada
Condensed Statement of Change in Net Debt for the Year Ended March 31, 2006

	2006		Restated (Note 2) 2005
	Budget[1]	Actual	Actual
		($ millions)	
Net debt, beginning of year	**549,600**[2]	**549,587**	**551,002**
Change in net debt during the year			
Annual surplus	(4,000)[3]	(13,218)	(1,463)
Acquisition of tangible capital assets	4,800	4,046	4,619
Amortization of tangible capital assets	(3,900)	(3,904)	(3,696)
Other		435	(875)
Net decrease in net debt	(3,100)	(12,641)	(1,415)
Net debt, end of year	**546,500**	**536,946**	**549,587**

[1] Derived from Budget 2005.

[2] Adjusted to the actual closing amount of previous year.

[3] Budget 2005 disclosed the budgetary surplus as $4 billion before deducting reserves for contingency ($3 billion) and economic prudence ($1 billion).

Table 12

Government of Canada
Condensed Statement of Cash Flow for the Year Ended March 31, 2006

	2006	Restated (Note 2) 2005
	($ millions)	
Cash provided by operating activities		
Annual surplus	13,218	1,463
Items not affecting cash	(4,751)	4,527
	8,467	**5,990**
Cash used for capital investment activities	**(3,900)**	**(4,475)**
Cash provided by investing activities	**468**	**3,071**
Total cash generated	***5,035***	***4,586***
Cash used to repay unmatured debt	**(4,501)**	**(4,543)**
Net increase in cash	**534**	**43**
Cash at beginning of year	20,615	20,572
Cash at end of year	**21,149**	**20,615**

Notes to the Condensed Financial Statements of the Government of Canada

1. Summary of Significant Accounting Policies

The reporting entity of the Government of Canada includes all departments, agencies, corporations, organizations and funds, which are controlled by the Government. The financial activities of all these entities are consolidated in these financial statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the Government for financing their activities. These corporations are reported under the modified equity basis of accounting. The Canada Pension Plan is excluded from the reporting entity as it is under the joint control of the Government and participating provinces.

The Government accounts for transactions on an accrual basis, using the Government's accounting policies that are described in Note 1 to its audited financial statements, which are based on Canadian generally accepted accounting principles for the public sector. The use of these stated accounting policies does not result in any significant differences from Canadian generally accepted accounting principles.

Financial assets recorded on the Condensed Statement of Financial Position can provide resources to discharge liabilities or finance future operations and are recorded at the lower of cost or net realizable value. Non-financial assets cannot normally be converted into cash to finance future operations without disrupting government operations; they are recorded at cost less accumulated amortization. Liabilities are recorded at the estimated amount ultimately payable, with pension and other future benefits being determined on an actuarial basis. Allowances for valuation are established for loan guarantees, concessionary and sovereign loans, and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the Government. By their nature, such estimates are subject to measurement uncertainty, although the Government believes them to be reasonable.

Comparative figures have been reclassified to conform to the current year's presentation.

2. Change in Accounting Policy

During 2005–06, the Government retroactively adopted the new recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants regarding the government reporting entity. As a consequence, some organizations that were previously not part of the Government's reporting entity are now included in the Government's financial statements through either consolidation or the modified equity basis of accounting.

The impact of the change on the 2005 opening accumulated deficit and net debt is as follows:

	Accumulated deficit	Net debt
	($ millions)	
Government's holdings of unmatured debt	(1,000)	(1,000)
Investments in enterprise Crown corporations and other government business enterprises	49	49
Other loans, investments and advances and other net assets	(4,358)	(4,358)
Tangible capital assets	(4)	
Decrease in opening balance	(5,313)	(5,309)

3. Contractual Obligations

Contractual obligations that will materially affect the level of future expenses include transfer payment agreements, acquisitions of property and equipment, and goods and services, operating leases and funding of international organizations. At March 31, 2006, contractual obligations amounted to approximately $70 billion ($63 billion in 2005).

4. Contingent Liabilities

Guarantees by the Government and callable share capital in certain international organizations at March 31, 2006 amount to $144 billion ($126 billion in 2005) net of any recorded allowance. In addition, there are a number of contaminated sites where the Government could be obligated to incur costs. There are thousands of claims and pending and threatened litigation cases against the Government; the total amount claimed in these instances is significant but the final outcome is not determinable. Where cases are likely to be lost and an estimate of loss can be made, an amount is recorded in the financial statements. At March 31, 2006, insurance in force relating to self-sustaining insurance programs operated by three agent enterprise Crown corporations amounted to approximately $839 billion ($719 billion in 2005). The Government expects that it will not incur any costs to cover insurance claims under these programs.

Other Sources of Information

Public Accounts of Canada

The *Public Accounts of Canada*, as required under section 64(1) of the Financial Administration Act, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in three volumes:

- Volume I contains the Government's audited financial statements and supporting schedules and information.
- Volume II contains details of financial operations by ministry.
- Volume III contains additional information and analyses.

Budget

The budget, usually introduced in February, presents the Government's overall fiscal plan, incorporating revenue projections and spending plans, which combine to determine the resulting budgetary balance. The budget also introduces proposals for changes in taxation.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the Government together with the reasons underlying major variances.

Debt Management Strategy

This report is tabled annually in Parliament. It provides information on the federal government's debt management strategy for the coming fiscal year.

Debt Management Report

This annual document provides an accounting of the key elements of federal debt strategy and describes various strategic and operational aspects of the Government's debt program and cash management activities over the past fiscal year.

Estimates

Each year the Government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board and consist of three parts:

Part I – The Government Expenditure Plan provides an overview of federal spending and summarizes the relationship of the key elements of the Main Estimates to the Expenditure Plan set out in the budget.

Part II – The Main Estimates directly support the Appropriations Act.

Part III – Departmental Expenditure Plans consist of two components—Reports on Plans and Priorities and Departmental Performance Reports.

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Government
Publications

ANNUAL FINANCIAL REPORT OF THE GOVERNMENT OF CANADA

Fiscal Year 2006–2007

CANADA'S NEW GOVERNMENT

Canada

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Annual Financial Report

of the Government of Canada

Fiscal Year 2006–2007

Message from the Minister

We should be proud of Canada's strong economic performance over the past year. Our government has taken great care to create an environment that encourages further growth and investment. The key to our success has been our determination to develop our long-term economic plan, *Advantage Canada*, and put that plan into action.

Advantage Canada is designed to give Canada and Canadians five distinct advantages: a tax advantage, a fiscal advantage, a knowledge advantage, an infrastructure advantage and an entrepreneurial advantage.

As you can see in the 2006–07 Annual Financial Report, we are delivering on those advantages for Canadian individuals, families and businesses. Revenue growth is strong, government spending is focused and providing good value for money, our debt is lower and taxes are coming down.

In fact, as part of our Tax Back Guarantee, we are giving Canadians a direct stake and a direct benefit in how we manage government finances on their behalf. The higher-than-expected reduction in the federal debt in 2006–07 will result in approximately $260 million in additional ongoing personal income tax reductions. That's more money in the pockets of hard-working Canadians.

Since taking office our government has provided relief in every way we collected taxes: personal taxes, consumption taxes, excise taxes and corporate taxes. As we continue to implement *Advantage Canada*, we intend to provide further tax relief for Canadian families and businesses in a responsible and meaningful way.

Over the past two years the federal debt has been reduced by an amount equivalent to $1,142 for every Canadian man, woman and child. We will continue to lift that burden off the shoulders of future generations, and at the same time, invest in priority programs.

Our objectives are clear: more and better jobs; a higher standard of living; and greater opportunity for Canadians to learn, earn, and invest to create the future they want for themselves and their families.

We have come a long way in a short period of time and that has not gone unnoticed internationally. Canada remains a shining example to the rest of the world of what a truly great, prosperous and compassionate nation can be.

Jim Flaherty
Minister of Finance

Table of Contents

Note to Readers

The Government reports all revenues and expenses on an accrual basis. Further details on the Government's accounting policies can be found in the section entitled "Notes to the Condensed Financial Statements of the Government of Canada" and in the *Public Accounts of Canada 2007.*

During 2006–07, the Government adopted new recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants regarding the accounting treatment of other comprehensive income. Other comprehensive income consists of unrealized gains and losses on financial instruments held by enterprise Crown corporations and other government business enterprises. In accordance with the recommendations, other comprehensive income is recorded directly in the Government's Condensed Statement of Accumulated Deficit and Condensed Statement of Change in Net Debt, but is excluded from the calculation of the Government's annual surplus. Therefore, for 2006–07 and future years, the annual change in the federal debt (accumulated deficit) will reflect the annual budgetary balance plus any gains or losses recognized in other comprehensive income. This accounting policy change resulted in a $479-million decrease in the federal debt in 2006–07.

Report Highlights

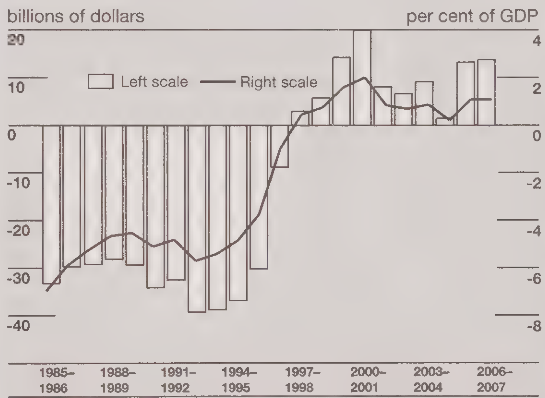
- A budgetary surplus of 1.0 per cent of gross domestic product (GDP), or $13.8 billion, was achieved in 2006–07.
- Federal debt stood at $467.3 billion at the end of 2006–07, down $95.6 billion from its peak of $562.9 billion in 1996–97. Over the past two years the federal debt has fallen by an amount equivalent to $1,142 for each Canadian.
- The federal debt-to-GDP ratio is 32.3 per cent, down sharply from its peak of 68.4 per cent in 1995–96, and is now at its lowest level in 25 years.
- Unmatured debt—the debt issued on credit markets to investors—as a percentage of GDP has declined to 28.6 per cent from the peak of 57.7 per cent in 1995–96.
- The share of revenues spent on public debt charges declined from 15.2 per cent in 2005–06 to 14.4 per cent in 2006–07. This is down from a peak of about 38 per cent in 1990–91. The share of revenues devoted to public debt charges is now at its lowest level since the late 1970s.
- The 2006–07 surplus is $4.6 billion, or 1.0 per cent of combined revenues and expenses, higher than the $9.2-billion surplus forecast in the March 2007 budget, due largely to higher-than-expected corporate income tax revenues. Program expenses were $0.7 billion lower than estimated in Budget 2007, while public debt charges were $0.2 billion lower than forecast.

The Budgetary Balance

A budgetary surplus of $13.8 billion was recorded in 2006–07. Budgetary revenues increased by 6.2 per cent over the prior year. This gain was due to strong growth in income tax revenues, which was only partially offset by a decrease in goods and services tax (GST) revenues due to the impact of the July 1, 2006, GST rate reduction. Program expenses rose by 7.5 per cent as a result of higher transfers to individuals and to other levels of government, as well as higher operating expenses. Public debt charges increased by $0.2 billion, or 0.5 per cent, due to a higher average effective interest rate on the stock of interest-bearing debt.

In the absence of policy changes, the budgetary balance primarily mirrors economic developments. To enhance the comparability of financial results over time and across jurisdictions, the budgetary balance and its components are often presented as a percentage of GDP.

Budgetary Balance



Sources: *Public Accounts of Canada* and Statistics Canada.

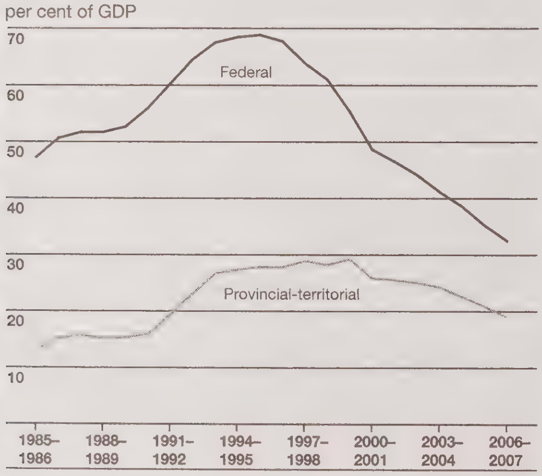
The budgetary surplus was 1.0 per cent of GDP in 2006–07. This ratio was unchanged from 2005–06.

All orders of government in Canada continue to post strong fiscal results. In 2006–07 the provinces and territories were in a strong surplus position due to ongoing revenue growth, particularly personal and corporate

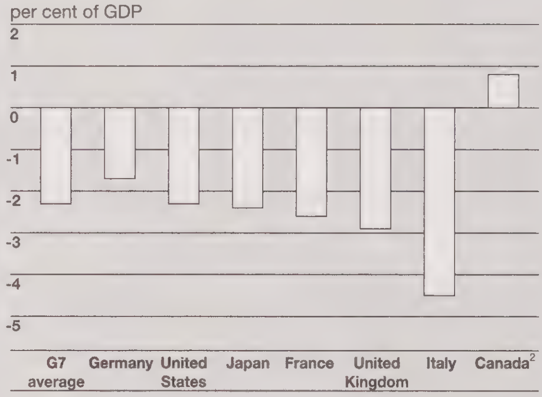
income tax revenues. The aggregate provincial-territorial surplus is currently estimated at $16.1 billion[1] for 2006–07, up from the $13.6-billion aggregate surplus posted in 2005–06. This would mark the third consecutive year that the aggregate provincial-territorial surplus has exceeded the federal surplus.

As a result of improving budgetary balances and economic growth in recent years, both federal and provincial-territorial debts have declined as a share of GDP. Federal debt as a share of GDP still exceeds that of most provinces and remains significantly higher than the provincial average. Lower debt has enabled both orders of government to allocate a smaller portion of revenues to debt interest payments, freeing up funds to reduce taxes and invest in other priorities. Lower debt also strengthens our country's ability to deal with economic shocks and challenges, such as the aging of our population.

Federal and Provincial-Territorial Debt



Total Government Financial Balances[1] (2006)



[1] The OECD uses the term "financial balance" to mean budgetary balance.
[2] The data for Canada do not yet reflect the final 2006–07 results, and will therefore likely be revised upward.
Source: *OECD Economic Outlook*, No. 81 (June 2007).

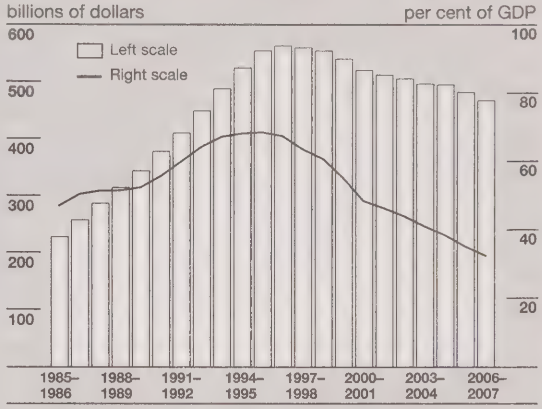
The Organisation for Economic Co-operation and Development (OECD) estimates that Canada was the only G7 country to record a total government surplus in calendar year 2006. Moreover, it expects Canada to continue to be the only G7 country to post a surplus again in 2007 and 2008.

[1] Based on final results for Nova Scotia, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia and 2007 budget estimates for the remaining jurisdictions.

Federal Debt

The federal debt is the difference between the Government's total liabilities and its assets. At the end of 2006–07 the federal debt stood at $467.3 billion, down $95.6 billion from its peak of $562.9 billion in 1996–97. As a share of GDP, federal debt dropped to 32.3 per cent in 2006–07, down from the peak of 68.4 per cent in 1995–96, bringing it to its lowest level since 1981–82. Federal debt at the end of 2006–07 was $14,223 for each Canadian, down from $15,365 two years earlier.

Federal Debt (Accumulated Deficit)



Sources: *Public Accounts of Canada* and Statistics Canada.

Federal Debt (Accumulated Deficit)

The financial statements of the Government of Canada are presented on a full accrual basis of accounting. On this basis, government debt can be defined in several ways.

Net debt represents the total liabilities of the Government less its financial assets. Financial assets consist of cash and other accounts receivable, tax receivables, foreign exchange accounts, and loans, investments and advances.

The accumulated deficit is equal to total liabilities less total assets—both financial and non-financial. Non-financial assets include tangible capital assets (such as land and buildings), inventories and prepaid expenses. Prior to 2006–07, the accumulated deficit was also equal to the net accumulation of all annual surpluses and deficits since Confederation. However, as discussed in the "Note to Readers" section, the accumulated deficit now includes accumulated other comprehensive income, which is excluded from the calculation of the Government's surplus, in accordance with recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants.

The federal debt, referred to in the budget documents and the *Annual Financial Report of the Government of Canada*, is the accumulated deficit. It is the federal government's main measure of debt.

Table 1
Financial Highlights

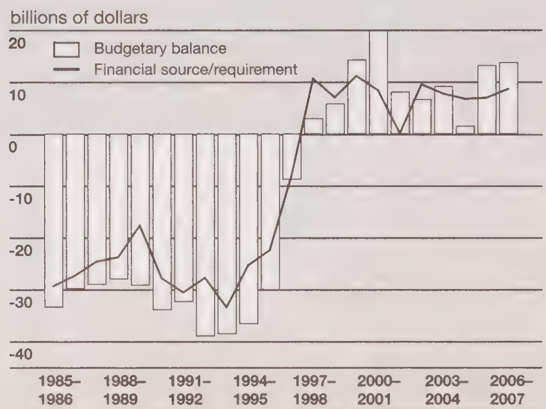
	2005–06	2006–07
	($ billions)	
Budgetary transactions		
Revenues	222.2	236.0
Expenses		
Program expenses	-175.2	-188.3
Public debt charges	-33.8	-33.9
Total expenses	-209.0	-222.2
Budgetary balance	**13.2**	**13.8**
Non-budgetary transactions	-6.4	-5.2
Financial source/requirement	6.8	8.5
Net change in financing activities	-6.3	-7.0
Net change in cash balances	0.5	1.5
Cash balance at end of period	21.1	22.7
Financial position		
Total liabilities	702.5	705.8
Total financial assets	165.6	181.9
Net debt	536.9	523.9
Non-financial assets	55.4	56.6
Federal debt (accumulated deficit)	**481.5**	**467.3**
Financial results (% of GDP)		
Budgetary revenues	16.2	16.3
Program expenses	12.7	13.0
Public debt charges	2.5	2.3
Budgetary balance	1.0	1.0
Federal debt (accumulated deficit)	35.0	32.3

Note: Numbers may not add due to rounding.

Financial Source/Requirement

The financial source/requirement measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance, which measures revenues and expenses as they are earned or incurred rather than when the associated cash is received or paid. There was a financial source of $8.5 billion in 2006–07, compared to a financial source of $6.8 billion in 2005–06.

Budgetary Balance and Financial Source/Requirement



Sources: *Public Accounts of Canada* and Statistics Canada.

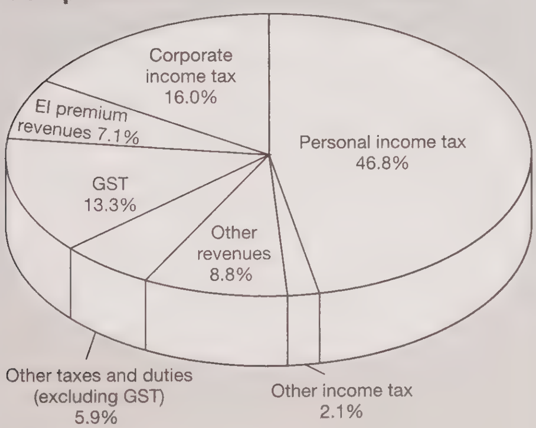
Budgetary Revenues

Budgetary revenues totalled $236.0 billion in 2006–07, up 6.2 per cent from 2005–06 (Table 2). Tax revenues rose by $12.3 billion, or 6.6 per cent, while Employment Insurance (EI) premium revenues rose by $0.3 billion, or 1.5 per cent. Other revenues increased by $1.2 billion, or 6.1 per cent. Budgetary revenues were $3.7 billion, or 1.6 per cent, higher than estimated in the March 2007 budget.

The largest source of budgetary revenues in 2006–07 was personal income tax revenues, which stood at 46.8 per cent of budgetary revenues. The second largest source was corporate income tax revenues at 16.0 per cent, up 10.3 percentage points from a low of 5.7 per cent in 1992–93. GST revenues were 13.3 per cent of budgetary revenues, while EI premium revenues contributed to 7.1 per cent of budgetary revenues.

Personal income tax revenues increased by $6.8 billion, or 6.5 per cent, in 2006–07. This reflects solid growth in employment and wages and salaries combined with the progressive nature of the personal income tax system.

Composition of Revenues for 2006–07



Source: *Public Accounts of Canada.*

Personal income tax revenues usually grow somewhat faster than personal income—in other words, they have an “income elasticity” greater than one—because marginal tax rates rise as taxable income rises. These factors pushing up revenues were partially offset by tax relief measures announced in the March 2007 budget and the October 2006 Tax Fairness Plan.

Corporate income tax revenues were $6.0 billion, or 19.0 per cent, higher in 2006–07 than in 2005–06. Growth in corporate income tax revenues far exceeded growth in corporate profits as measured in the National Accounts, which rose by only 5.0 per cent in 2006. As such, the gain in corporate income tax revenues largely reflects a significantly higher tax yield per dollar of corporate income earned. The higher average effective tax rate is likely due to a decline in corporate loss pools. After five consecutive years of profit growth, corporations have a dwindling supply of prior-year losses available to reduce their tax liabilities. Indeed, there appear to be a number of large corporations, particularly in the resource sector, that have just recently started paying income taxes as they have exhausted their pools of losses or credits. The cause of the increase in the average effective tax rate can only be confirmed in two years, when detailed assessment data will be available. In addition, corporate income tax revenues reported in 2006–07 were boosted by an unusually high level of corporate income tax pertaining to the prior year that was assessed after the financial statements for 2005–06 were closed, and for which corresponding instalment payments had been underpaid. This boosted corporate income tax revenues in 2006–07 by more than $1 billion.

Other income tax revenues—largely withholding taxes levied on non-residents—were $0.3 billion, or 7.7 per cent, higher in 2006–07 than in the previous year.

Other taxes and duties decreased by $0.8 billion, or 1.8 per cent, in 2006–07, driven by a $1.7-billion drop in GST revenues, reflecting the impact of the July 1, 2006, GST rate reduction. This decline was partially offset by the one-time charge on duty deposit refunds under the Canada-United States Softwood Lumber Agreement, which raised other excise taxes and duties by $0.5 billion. Other excise taxes and duties were also boosted by the introduction of an export charge on softwood lumber exports to the U.S., effective October 12, 2006, consistent with the Agreement. There is no net budgetary impact from either the charge on duty deposit refunds or the export charge: revenues from the former have been transferred to certain U.S. interests under the terms of the Agreement and revenues from the latter, net of the costs of administering the Agreement, will be transferred to provincial governments. Customs import duties rose $0.4 billion, or 11.2 per cent.

EI premium revenues increased by $0.3 billion, or 1.5 per cent, from the previous year, reflecting growth in employment and wages and salaries during the year, which more than offset the reductions in premium rates on January 1, 2006 and January 1, 2007, as well as the impact of the transfer to the province of Quebec of the responsibility for delivering maternity and parental benefits in that province along with the associated premiums, effective January 1, 2006.

Other revenues consist of net profits from Crown corporations, such as the Bank of Canada, Export Development Canada and Canada Mortgage and Housing Corporation; foreign exchange revenues; and other program revenues, primarily revenues from the sales of goods and services. Other revenues were up $1.2 billion, or 6.1 per cent, in 2006–07, primarily reflecting growth in interest and penalties on outstanding balances of taxes receivable.

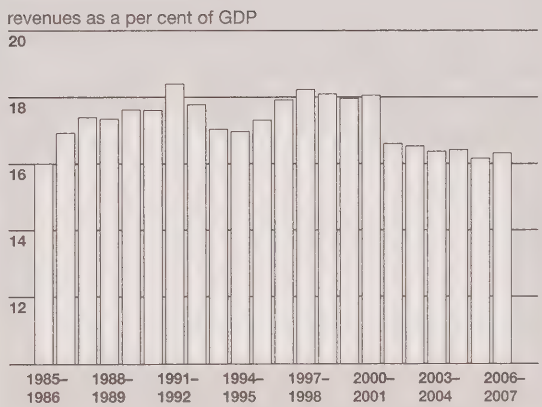
Table 2
Revenues

	2005–06	2006–07	Net change	
		($ millions)		(%)
Tax revenues				
Income tax				
Personal income tax	103,691	110,477	6,786	6.5
Corporate income tax	31,724	37,745	6,021	19.0
Other income tax	4,529	4,877	348	7.7
Total	139,944	153,099	13,155	9.4
Other taxes and duties				
Goods and services tax	33,020	31,296	-1,724	-5.2
Energy taxes	5,076	5,128	52	1.0
Customs import duties	3,330	3,704	374	11.2
Air Travellers Security Charge	353	357	4	1.1
Other excise taxes and duties	4,377	4,832	455	10.4
Total	46,156	45,317	-839	-1.8
Total tax revenues	**186,100**	**198,416**	**12,316**	**6.6**
Employment Insurance premium revenues	**16,535**	**16,789**	**254**	**1.5**
Other revenues				
Crown corporation revenues	7,198	7,503	305	4.2
Foreign exchange revenues	2,014	1,714	-300	-14.9
Other program revenues	10,356	11,544	1,188	11.5
Total	19,568	20,761	1,193	6.1
Total revenues	**222,203**	**235,966**	**13,763**	**6.2**

Note: Numbers may not add due to rounding.

The revenue ratio—budgetary revenues as a percentage of GDP—compares the total of all federal revenues to the size of the economy. The revenue ratio stood at 16.3 per cent in 2006–07, up from 16.2 per cent in 2005–06. This increase is primarily due to the significant growth of corporate income tax revenues.

Revenue Ratio



Sources: Department of Finance and Statistics Canada.

Total Expenses

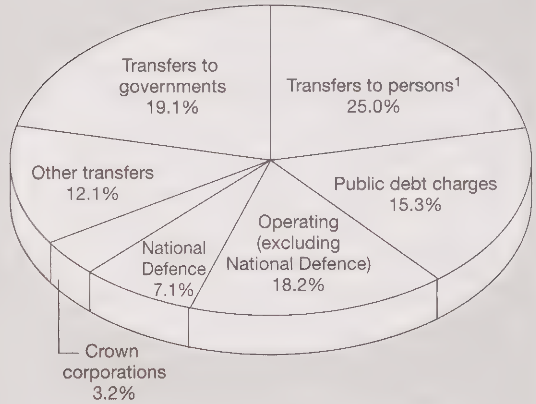
Total expenses consist of program expenses and public debt charges. In 2006–07 total expenses amounted to $222.2 billion, up 6.3 per cent from 2005–06.

Major transfers to persons (elderly benefits, EI benefits, and children's benefits) and major transfers to other levels of government (the Canada Health Transfer, the Canada Social Transfer, fiscal arrangements and other transfers, transfers to provinces on behalf of Canada's cities and communities, and Alternative Payments for Standing Programs) were the two largest components of total expenses in 2006–07, representing 25.0 and 19.1 per cent of total expenses. Other transfers made by various federal departments to individuals, businesses and other organizations and groups made up 12.1 per cent of total expenses in 2006–07.

After transfers, the next largest component of total expenses was the operating costs of government departments and agencies, excluding National Defence, at 18.2 per cent. Operating costs include items such as salaries and benefits, facilities and equipment, and supplies and travel.

Public debt charges amounted to 15.3 per cent of total expenses in 2006–07. This is down from a peak of nearly 30 per cent in the mid-1990s, when they were the largest component of spending, reflecting the large stock of interest-bearing debt and high average effective interest rates on that stock. With the reductions in interest-bearing debt and lower interest rates, their share of total expenses has fallen 14.5 percentage points from a high of 29.8 per cent in 1996–97.

Composition of Expenses for 2006–07



[1] Includes elderly benefits, EI benefits, and children's benefits.
Source: *Public Accounts of Canada.*

Program expenses amounted to $188.3 billion in 2006–07, up 7.5 per cent from 2005–06 (Table 3). Within program expenses, transfers increased by $6.6 billion and operating expenses of departments and agencies, excluding National Defence, increased by $5.7 billion. Operating expenses of National Defence grew by $0.7 billion while Crown corporation expenses were virtually unchanged.

Public debt charges rose by $0.2 billion, or 0.5 per cent, reflecting higher average effective interest rates on the stock of interest-bearing debt.

Table 3
Total Expenses

	2005–06	2006–07	Net change	
		($ millions)		(%)
Major transfers to persons				
Elderly benefits	28,992	30,284	1,292	4.5
Employment Insurance benefits	14,417	14,084	-333	-2.3
Children's benefits	9,200	11,214	2,014	21.9
Total	52,609	55,582	2,973	5.7
Major transfers to other levels of government				
Support for health and other programs	27,225	28,640	1,415	5.2
Fiscal arrangements and other transfers	12,439	13,066	627	5.0
Canada's cities and communities	582	590	8	1.4
Transfers in support of post-secondary education, public transit and affordable housing	3,300		-3,300	
Early learning and child care		650	650	
Clean Air and Climate Change Trust Fund		1,519	1,519	
Patient Wait Times Guarantee Trust		612	612	
Transition Trust		614	614	
Alternative Payments for Standing Programs	-2,731	-3,177	-446	16.3
Total	40,815	42,514	1,699	4.2
Direct program expenses				
Subsidies and other transfers[1]	24,893	26,844	1,951	7.8
Other program expenses				
Crown corporations				
Canada Mortgage and Housing Corporation	2,119	2,102	-17	-0.8
Canadian Broadcasting Corporation	1,672	1,666	-6	-0.4
Other cultural agencies	631	606	-25	-3.9
Canadian Air Transport Security Authority	349	438	89	25.4
Other	2,424	2,399	-25	-1.0
Total	7,195	7,211	16	0.2
National Defence	15,034	15,732	698	4.6
All other departments and agencies				
Bad debt expense	1,366	4,179	2,813	205.9
Other operating expenses	33,301	36,207	2,906	8.7
Total	34,667	40,386	5,719	16.5
Total other program expenses	56,896	63,329	6,433	11.3
Total direct program expenses	81,789	90,173	8,384	10.3
Total program expenses	**175,213**	**188,269**	**13,056**	**7.5**
Public debt charges	33,772	33,945	173	0.5
Total expenses	**208,985**	**222,214**	**13,229**	**6.3**

Note: Numbers may not add due to rounding.

[1] See Table 4 for details.

In 2006–07 major transfers to persons increased by $3.0 billion, or 5.7 per cent, over 2005–06.

- Elderly benefits consist of Old Age Security, the Guaranteed Income Supplement and Allowance payments (formerly known as the Spousal Allowance). Total benefits were up $1.3 billion, or 4.5 per cent, in 2006–07, reflecting an $18-per-month increase in the Guaranteed Income Supplement in both January 2006 and January 2007, as well as an increase in the number of recipients.
- EI benefits consist of regular benefits, special benefits (sickness, maternity, parental, adoption and fishing) and labour market adjustment benefits. Total benefits decreased by $0.3 billion in 2006–07, reflecting a decline in maternity and parental benefits, due to the transfer to the province of Quebec of the responsibility for delivering maternity and parental benefits in that province, effective January 1, 2006.
- Children's benefits consist of the base Canada Child Tax Benefit, the National Child Benefit supplement, the Child Disability Benefit and the new Universal Child Care Benefit (UCCB). The $2.0-billion, or 21.9-per-cent, increase in children's benefits in 2006–07 is mainly attributable to transfers under the UCCB program, which began in July 2006.

Major transfers to other levels of government include the Canada Health Transfer (CHT), the Canada Social Transfer (CST), fiscal arrangements (Equalization, transfers to the territories, as well as a number of smaller transfer programs), transfers to provinces on behalf of Canada's cities and communities, and Alternative Payments for Standing Programs. These transfers increased by $1.7 billion, or 4.2 per cent, over 2005–06, resulting largely from legislated increases in the CHT, the CST, Equalization and Territorial Formula Financing in 2006–07.

- The CHT and CST—block-funded transfers—support health care, post-secondary education, social assistance and social services, including early childhood development. These programs provide support in the form of cash and tax transfers to the provinces and territories. Transfers in support of health and other social programs increased by $1.4 billion in 2006–07, reflecting legislated increases in the CHT and the CST transfers in 2006–07.
- Total entitlements under fiscal arrangements and other transfers increased by $0.6 billion to $13.1 billion in 2006–07.
- In Budget 2007, the Government announced one-time transfers to provinces and territories to support a number of initiatives including health care, post-secondary education, labour market training and the environment. These transfers included the creation of the $1.5-billion Clean Air and Climate Change Trust Fund, the $0.6-billion Patient Wait Times Guarantee Trust and the $0.6-billion Transition Trust.
- The 2006–07 results also include a $650-million one-time payment made in July 2006 to provinces and territories under the Early Learning and Child Care Agreements.
- Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allow provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provides provinces with tax points, the value of which are netted against total entitlements and accordingly recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

In 2006–07 subsidies and other transfers increased by $2.0 billion, or 7.8 per cent, over 2005–06 (Table 4). This growth largely reflects increased agricultural assistance announced in Budget 2006, $0.5 billion in transfers to U.S. interests under the Canada-United States Softwood Lumber Agreement, and a $0.4-billion transfer to the Canada Health Infoway to support early movement by provinces towards patient wait times guarantees.

Table 4
Subsidies and Other Transfers

	2005–06	2006–07	Net change	
		($ millions)		(%)
Agriculture and Agri-Food				
Grains and Oilseeds Payment Program	756	0	-756	-100.0
CAIS (Canadian Agricultural Income Stabilization) Inventory Transition Initiative		873	873	n/a
Cost of Production Payment		400	400	n/a
Other	1,839	1,849	10	0.5
Total	2,595	3,122	527	20.3
Foreign Affairs and International Trade				
Canada-United States Softwood Lumber Agreement		503	503	n/a
Other	3,357	3,501	144	4.3
Total	3,357	4,004	647	19.3
Health				
First Nations and Inuit health	857	927	70	8.1
Canadian Institutes of Health Research	758	800	41	5.5
Primary Health Care Transition Fund	185	73	-112	-60.7
Canada Health Infoway		400	400	n/a
Other	281	315	35	12.3
Total	2,080	2,514	434	20.8
Human Resources and Skills Development				
Student assistance programs	848	874	26	3.1
Labour market programs	746	740	-6	-0.8
Energy Cost Benefit	210	4	-207	-98.3
Other	389	300	-89	-22.9
Total	2,193	1,918	-275	-12.6
Indian and Northern Affairs	5,448	5,161	-287	-5.3
Industry/regional agencies/granting councils				
Technology Partnerships Canada	452	342	-109	-24.2
Infrastructure Canada	368	286	-83	-22.4
Regional agencies	537	613	76	14.1
Natural Sciences and Engineering Research Council of Canada/Social Sciences and Humanities Research Council of Canada	1,371	1,458	88	6.4
CANARIE		120	120	n/a
Genome Canada		100	100	n/a
Other	266	273	7	2.6
Total	2,994	3,192	198	6.6
Other	6,225	6,933	708	11.4
Total	24,893	26,844	1,951	7.8

Note: Numbers may not add due to rounding.

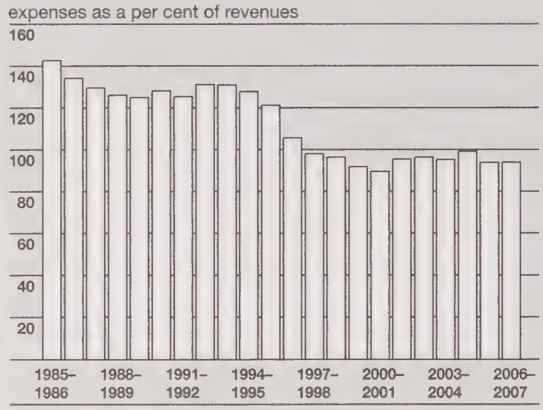
Other program expenses—total program expenses less transfers—consist of the operating costs of the more than 130 departments, agencies, Crown corporations and other federal bodies that deliver programs and services to Canadians. These expenses amounted to $63.3 billion in 2006–07, up $6.4 billion, or 11.3 per cent, from 2005–06. Within this component:

- Expenses related to Crown corporations were virtually unchanged in 2006–07, increasing by $16 million, or 0.2 per cent, over 2005–06.
- National Defence expenses increased by $0.7 billion, or 4.6 per cent, primarily reflecting incremental annual funding to strengthen Canada's military.
- All other departmental and agency expenses increased by $5.7 billion, or 16.5 per cent. About half of this increase reflects a $2.8-billion increase in bad debt expense nearly all of which relates to taxes receivable. The increase in bad debt expense reflects a year-over-year increase in the stock of accounts receivable outstanding at year-end and a reduction in the estimated creditworthiness of those receivables. The other half is largely attributable to increased pension costs, reflecting the one-time impact of previously announced amendments to the public service pension plans. This is one of a series of changes that have been implemented over the past few years to improve the fairness and affordability of the public service pension plans over the long run.

The expense ratio—total expenses as a percentage of budgetary revenues—stood at 94.2 per cent in 2006–07. An expense ratio of less than 100 means that revenues exceed expenses, resulting in a surplus. The expense ratio has been less than 100 since the federal government first recorded a surplus in 1997–98. This is in sharp contrast to the previous 27 years, in which revenues did not cover expenses.

Public debt charges increased by $0.2 billion, or 0.5 per cent, to $33.9 billion in 2006–07,

Expense ratio

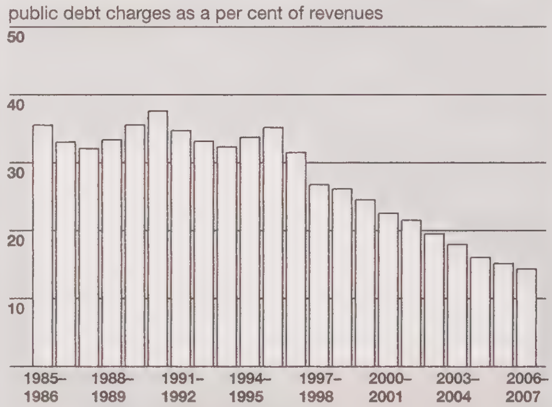


Source: Department of Finance.

due to higher average effective interest rates on the stock of interest-bearing debt.

The interest ratio—public debt charges as a percentage of budgetary revenues—declined from 15.2 per cent in 2005–06 to 14.4 per cent in 2006–07. This ratio means that, in 2006–07, the Government spent about 14 cents of every revenue dollar on interest on the public debt. This is down from the peak of about 38 cents in 1990–91 and is the lowest this ratio has been since the late 1970s. This is money that must be paid to meet the Government's ongoing obligations on its debt. The lower the ratio, the more flexibility the Government has to address the key priorities of Canadians.

Interest Ratio



Source: Department of Finance.

The Budgetary Balance and Financial Source/Requirement

The budgetary balance is the most comprehensive measure of the federal government's fiscal results. It is presented on a full accrual basis of accounting, recording government liabilities when they are incurred, regardless of when the cash payment is made, and recording tax revenues when earned, regardless of when the cash is received.

In contrast, the financial source/requirement measures the difference between cash coming in to the Government and cash going out. It differs from the budgetary balance in that it includes cash transactions in loans, investments and advances, federal employees' pension accounts, other specified purpose accounts, foreign exchange activities, and changes in other financial assets, liabilities and non-financial assets. These activities are included as part of non-budgetary transactions. The conversion from full accrual to cash accounting is also reflected in non-budgetary transactions.

Non-budgetary transactions in 2006–07 resulted in a net requirement of funds amounting to $5.2 billion, compared to a net requirement of $6.4 billion in 2005–06.

The non-budgetary requirement of funds in 2006–07 was due to cash requirements resulting from the acquisition of capital assets and loans, financial investments and advances, as well as from other activities, including payment of accounts payable, increases in accounts receivable and foreign exchange activities. These were partly offset by a source of funds related to public sector pension benefits.

With a budgetary surplus of $13.8 billion and a net requirement from non-budgetary transactions of $5.2 billion, there was a financial source of $8.5 billion in 2006–07, up $1.7 billion from the $6.8-billion source posted in 2005–06 (Table 5).

With this financial source, the Government retired $7.0 billion of its unmatured debt and increased its cash balances by $1.5 billion. Cash balances at March 31, 2007, stood at $22.7 billion.

Table 5
Budgetary Balance, Financial Source/Requirement and Net Financing Activities

	2005–06	2006–07
	($ billions)	
Surplus for the year	**13.2**	**13.8**
Non-budgetary transactions		
Pension and other accounts		
Public sector pensions	1.5	3.7
Other employee and veteran future benefits	1.8	1.8
Canada Pension Plan	-2.6	-0.1
Other	-0.6	-0.2
Total	0.1	5.1
Non-financial assets	-0.6	-1.2
Loans, investments and advances	-3.7	-2.7
Other transactions		
Accounts payable, receivable, accruals and allowances	-2.3	-3.1
Foreign exchange activities	0.0	-3.4
Total other transactions	-2.2	-6.5
Total non-budgetary transactions	-6.4	-5.2
Financial source/requirement	**6.8**	**8.5**
Net change in financing activities		
Marketable bonds	-4.7	-3.7
Treasury bills	4.4	2.5
Canada Savings Bonds	-1.7	-2.2
Other	-4.3	-3.6
Total	-6.3	-7.0
Change in cash balances	0.5	1.5
Cash at end of year	**21.1**	**22.7**

Note: Numbers may not add due to rounding.

Federal Debt

Total liabilities consist of interest-bearing debt and accounts payable and accrued liabilities. Interest-bearing debt includes unmatured debt and liabilities for pension and other accounts. At March 31, 2007, interest-bearing debt amounted to $599.3 billion, down $1.8 billion from March 31, 2006 (Table 6). Within interest-bearing debt, unmatured debt decreased by $7.0 billion while liabilities for pension and other accounts increased by $5.1 billion. Accounts payable and accrued liabilities amounted to $106.5 billion, up $5.1 billion from 2005–06. As a result, total liabilities at March 31, 2007 stood at $705.8 billion, up $3.3 billion from the previous year.

Financial assets consist of cash and other accounts receivable, tax receivables, foreign exchange accounts, and loans, investments and advances. Financial assets totalled $181.9 billion at March 31, 2007, up $16.3 billion from March 31, 2006. Increases were recorded in cash and other accounts receivable (up $2.4 billion), tax receivables (up $7.4 billion), loans, investments and advances (up $3.2 billion) and foreign exchange accounts (up $3.4 billion). As a result, net debt stood at $523.9 billion at March 31, 2007, down $13.0 billion from March 31, 2006, and $85.1 billion below the peak of $609 billion at March 31, 1997. As a per cent of GDP, net debt dropped to 36.2 per cent in 2006–07, down 37.7 percentage points from its peak of 73.9 per cent in 1995–96. This is the 11th consecutive year in which the net debt-to-GDP ratio has declined.

Non-financial assets, consisting of tangible capital assets, inventories and prepaid expenses, amounted to $56.6 billion at March 31, 2007, up $1.2 billion from March 31, 2006.

With total liabilities of $705.8 billion, financial assets of $181.9 billion and non-financial assets of $56.6 billion, the federal debt (accumulated deficit) stood at $467.3 billion at March 31, 2007, down $14.2 billion from 2005–06 and $95.6 billion from its peak in 1996–97. The decline in federal debt between 2005–06 and 2006–07 was largely due to an increase in financial assets.

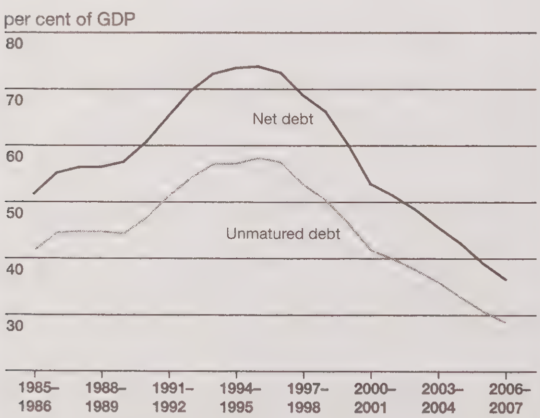
The reduction in the federal debt results in effective interest savings that will be passed on to Canadians through personal income tax reductions under the Government's Tax Back Guarantee. These effective interest savings result not only from reductions in the Government's market debt, but also from increases in its financial assets. For example, the Government's ownership interests in enterprise Crown corporations and other government business enterprises generate returns in the form of corporate profits. Similarly, reserves held in the foreign exchange accounts are generally invested in marketable securities which yield investment returns. The Government also earns interest revenue from the issuance of loans and advances.

Table 6
Outstanding Debt at Year-End

	2005–06	2006–07
	($ billions)	
Liabilities		
Accounts payable and accrued liabilities	101.4	106.5
Interest-bearing debt		
Unmatured debt	421.1	414.2
Pension and other liabilities	179.9	185.1
Total	601.1	599.3
Total liabilities	702.5	705.8
Financial assets		
Cash and other accounts receivable	23.7	26.1
Tax receivables	59.1	66.5
Foreign exchange accounts	40.8	44.2
Loans, investments and advances	41.9	45.1
Total financial assets	165.6	181.9
Net debt	**536.9**	**523.9**
Non-financial assets		
Tangible capital assets	48.4	49.0
Inventories	5.9	6.0
Prepaid expenses	1.2	1.6
Total non-financial assets	55.4	56.6
Federal debt (accumulated deficit)	**481.5**	**467.3**

Note: Numbers may not add due to rounding.

Net Debt and Unmatured Debt



Source: Department of Finance.

Both net debt and unmatured debt, expressed as a percentage of GDP, are now below their respective levels in the early 1980s.

Comparison of Actual Budgetary Outcomes to Budget Estimates

This section compares the actual outcome for the major components of the budgetary balance for 2006–07 to the estimates presented in the March 2007 budget. The Government estimated a surplus of $9.2 billion for 2006–07 in the March 2007 budget. This amount was allocated to planned federal debt reduction. The final audited budgetary surplus for 2006–07 is $13.8 billion.

The increase in the 2006–07 surplus compared to the March 2007 budget estimate is largely attributable to higher-than-anticipated corporate income tax revenues.

Total revenues were 1.6 per cent, or $3.7 billion, higher than projected in the budget. Corporate income tax revenues were $2.7 billion higher than projected, as revenues rose by significantly more than profits across a number of sectors. Budget 2007 projections were prepared based on data up to January 2007, at which time corporate income tax revenues were up 12.4 per cent. Over the remaining two months of the fiscal year, corporate income tax revenues rose nearly 20 per cent. These gains, plus year-end adjustments, which reflect assessments up to the end of May 2007, raised the growth rate for the year as a whole to 19.0 per cent, well above the increase in the tax base. An unusually high level of corporate income tax pertaining to the prior year was assessed after the financial statements for 2005–06 were closed, for which instalments had been underpaid.

Non-tax revenues (excluding EI premium revenues) were $1.1 billion higher than projected in the budget, reflecting growth in interest and penalties on outstanding balances of taxes receivable along with growth in profits of Crown corporations. Excise taxes and duties were $0.9 billion higher than projected, primarily reflecting the impact of a one-time systems change and stronger-than-expected growth in GST revenues.

Program expenses were 0.4 per cent, or $0.7 billion, lower than forecast in the 2007 budget. Actual results were lower than forecast in all major categories of spending. The Government is committed to only approving funds that are actually needed to achieve measurable results in a way that is effective and provides value for money on behalf of Canadians. Within major transfers to persons, elderly benefits were marginally lower than expected ($0.2 billion), while recoveries under Alternative Payments for Standing Programs, which reduce major transfers to other levels of government, were $0.3 billion higher than expected at the time of Budget 2007. Direct program expenses, which include subsidies and other transfers, spending by Crown corporations, and operating expenses of departments and agencies, including National Defence, were $0.1 billion lower than forecast in Budget 2007. Within direct program expenses, bad debt expenses were $1.2 billion higher than forecast in Budget 2007. This increase was more than offset by lower-than-forecast departmental spending, reflecting in part a higher-than-forecast lapse in departmental spending authorities.

Public debt charges were 0.5 per cent, or $0.2 billion, lower than estimated.

Table 7
Comparison of Actual Outcomes to March 2007 Budget

	Actual	2007 budget[1]	Difference
		($ billions)	
Budgetary revenues			
Personal income tax	110.5	111.6	-1.2
Corporate income tax	37.7	35.0	2.7
Other income tax	4.9	5.4	-0.5
Excise taxes and duties	45.3	44.4	0.9
Employment Insurance premium revenues	16.8	16.1	0.7
Other revenues	20.8	19.7	1.1
Total	236.0	232.3	3.7
Program expenses			
Major transfers to persons			
Elderly benefits	30.3	30.5	-0.2
Employment Insurance benefits	14.1	14.2	-0.1
Children's benefits	11.2	11.1	0.1
Total	55.6	55.8	-0.2
Major transfers to other levels of government			
Federal transfers in support of health and other programs	28.6	28.6	0.0
Fiscal arrangements and other transfers	13.1	13.1	0.0
Canada's cities and communities	0.6	0.6	0.0
Early learning and child care	0.7	0.7	0.0
Clean Air and Climate Change Trust Fund	1.5	1.5	0.0
Patient Wait Times Guarantee Trust	0.6	0.6	0.0
Transition Trust	0.6	0.6	0.0
Alternative Payments for Standing Programs	-3.2	-2.9	-0.3
Total	42.5	42.9	-0.4
Direct program expenses			
Subsidies and other transfers	26.8	29.0	-2.1
Crown corporations	7.2	7.0	0.2
Departmental operating expenses	56.1	54.3	1.8
Total	90.2	90.3	-0.1
Total program expenses	188.3	189.0	-0.7
Public debt charges	33.9	34.1	-0.2
Budgetary outcome/estimate	**13.8**	**9.2**	**4.6**

Note: Numbers may not add due to rounding.

[1] Comparative figures from Budget 2007 have been reclassified to conform to the presentation in the Condensed Statement of Operations and Accumulated Deficit.

Auditor General of Canada
Vérificatrice générale du Canada

REPORT OF THE AUDITOR GENERAL ON THE CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

To the Minister of Finance

The accompanying condensed statements of operations and accumulated deficit, financial position, change in net debt and cash flow are derived from the complete financial statements of the Government of Canada as at March 31, 2007, and for the year then ended on which I expressed an opinion without reservation in my Report to the House of Commons dated August 24, 2007.

For more complete information, readers should refer to my Report, which will be included in Volume I of the *Public Accounts of Canada 2007*, expected to be tabled in the House of Commons later this year.

The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility, in accordance with the applicable Assurance Guideline of The Canadian Institute of Chartered Accountants, is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria described in the Guideline referred to above.

These summarized financial statements do not contain all the disclosures required by Canadian generally accepted accounting principles. Readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's results of operations and accumulated deficit, financial position, change in net debt and cash flow, reference should be made to the related complete financial statements, which will also be included in Volume I of the *Public Accounts of Canada 2007.*

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

Ottawa, Canada
August 24, 2007

Condensed Financial Statements of the Government of Canada

The fundamental purpose of these condensed financial statements is to provide an overview of the financial affairs and resources for which the Government is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the Government.

These financial statements are extracted and condensed from the audited financial statements included in Section 2 of Volume I of the *Public Accounts of Canada 2007*, which are expected to be tabled in Parliament later this year. As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 8
Government of Canada
Condensed Statement of Operations and Accumulated Deficit
for the Year Ended March 31, 2007

	2007		2006
	Budget[1]	Actual	Actual
		($ millions)	
Revenues			
Income tax revenues	148,990	153,099	139,944
Other taxes and duties	43,420	45,317	46,156
Employment insurance premiums	16,125	16,789	16,535
Other revenues	18,615	20,761	19,568
Total revenues	***227,150***	***235,966***	***222,203***
Expenses			
Transfer payments			
Old age security benefits and related payments	30,625	30,284	28,992
Other levels of government	40,075	42,514	40,815
Employment insurance benefits	14,580	14,084	14,417
Children's benefits	11,140	11,214	9,200
Other transfer payments	27,600	26,844	24,893
Total transfer payments	*124,020*	*124,940*	*118,317*
Other program expenses	64,785	63,329	56,896
Total program expenses	***188,805***	***188,269***	***175,213***
Public debt charges	34,788	33,945	33,772
Total expenses	***223,593***	***222,214***	***208,985***
Annual surplus	**3,557**	**13,752**	**13,218**
Accumulated deficit, beginning of year	**481,499**[2]	**481,499**	**494,717**
Other comprehensive income (Note 2)		**479**	
Accumulated deficit, end of year	**477,942**	**467,268**	**481,499**

The accompanying notes are an integral part of these statements.

[1] Derived from Budget 2006.

[2] Adjusted to the actual closing amount of previous year.

Table 9

Government of Canada
Condensed Statement of Financial Position
as at March 31, 2007

	2007	2006
	($ millions)	
Liabilities		
Accounts payable and accrued liabilities	106,511	101,432
Interest-bearing debt		
Unmatured debt	414,192	421,149
Pension and other liabilities	185,060	179,924
Total interest-bearing debt	*599,252*	*601,073*
Total liabilities	***705,763***	***702,505***
Financial assets		
Cash and accounts receivable	92,586	82,843
Foreign exchange accounts	44,178	40,827
Loans, investments and advances	45,094	41,889
Total financial assets	***181,858***	***165,559***
Net debt	***523,905***	***536,946***
Non-financial assets		
Tangible capital assets	49,036	48,355
Other	7,601	7,092
Total non-financial assets	***56,637***	***55,447***
Accumulated deficit	**467,268**	**481,499**

The accompanying notes are an integral part of these statements.

Table 10

Government of Canada
Condensed Statement of Change in Net Debt
for the Year Ended March 31, 2007

	2007		2006
	Budget[1]	Actual	Actual
		($ millions)	
Net debt, beginning of year	**536,946[2]**	**536,946**	**549,587**
Change in net debt during the year			
Annual surplus	-3,557	-13,752	-13,218
Acquisition of tangible capital assets	4,885	4,789	4,046
Amortization of tangible capital assets	-4,092	-3,807	-3,904
Other	-100	208	435
Net decrease in net debt due to operations	**-2,864**	**-12,562**	**-12,641**
Other comprehensive income (Note 2)		**-479**	
Net decrease in net debt	**-2,864**	**-13,041**	**-12,641**
Net debt, end of year	**534,082**	**523,905**	**536,946**

The accompanying notes are an integral part of these statements.

[1] Derived from Budget 2006.

[2] Adjusted to the actual closing amount of previous year.

Table 11

Government of Canada
Condensed Statement of Cash Flow
for the Year Ended March 31, 2007

	2007	2006
	($ millions)	
Cash provided by operating activities		
Annual surplus	13,752	13,218
Items not affecting cash	-1,662	-4,749
	12,090	8,469
Cash used by capital investment activities	**-4,587**	**-3,900**
Cash provided by investing activities	**2,289**	**466**
Total cash generated before financing activities	***9,792***	***5,035***
Cash used by financing activities	**-8,245**	**-4,501**
Net increase in cash	**1,547**	**534**
Cash at beginning of year	**21,149**	**20,615**
Cash at end of year	**22,696**	**21,149**
Supplementary information		
Cash used for interest	20,026	19,810

The accompanying notes are an integral part of these statements.

Notes to the Condensed Financial Statements of the Government of Canada

1. Summary of Significant Accounting Policies

The reporting entity of the Government of Canada includes all departments, agencies, corporations, organizations and funds, which are controlled by the Government. The financial activities of all these entities are consolidated in these financial statements, except for enterprise Crown corporations and other government business enterprises, which are not dependent on the Government for financing their activities. These corporations are reported under the modified equity basis of accounting. The Canada Pension Plan is excluded from the reporting entity because changes to the Plan require the agreement of two thirds of participating provinces and it is therefore not controlled by the Government.

The Government accounts for transactions on an accrual basis, using the Government's accounting policies that are described in Note 1 to its audited financial statements, which are based on Canadian generally accepted accounting principles for the public sector. The use of these stated accounting policies does not result in any significant differences from Canadian generally accepted accounting principles.

Financial assets recorded on the Condensed Statement of Financial Position can provide resources to discharge liabilities or finance future operations and are recorded at the lower of cost or net realizable value. Non-financial assets cannot normally be converted into cash to finance future operations without disrupting government operations; they are recorded at cost less accumulated amortization. Liabilities are recorded at the estimated amount ultimately payable. Within pension and other liabilities, obligations for pension and other employee and veteran future benefits are determined on an actuarial basis.

Allowances for valuation are established for loans, investments and advances, as well as for loan guarantees and other obligations.

Some amounts in these statements are based on estimates and assumptions made by the Government. By their nature, such estimates are subject to measurement uncertainty. The effect of changes to such estimates and assumptions in future periods could be significant to the financial statements, although, at the time of their preparation, the Government believes the estimates and assumptions to be reasonable. Some of the more significant estimates used in these financial statements affect the accrual of tax revenues and obligations for pension and other employee and veteran future benefits.

Comparative figures have been reclassified to conform to the current year's presentation.

2. Change in Accounting Policy

During 2006-2007, the Government adopted the new recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants regarding the recording of other comprehensive income resulting from the accounting of certain unrealized gains and losses on financial instruments by enterprise Crown corporations. In accordance with those recommendations, other comprehensive income is excluded from the calculation of the Government's annual surplus. It is instead recorded directly to the Government's Condensed Statement of Accumulated Deficit and Condensed Statement of Change in Net Debt.

This accounting policy change has resulted in an increase of $479 million in loans, investments and advances presented on the Condensed Statement of Financial Position and in a corresponding decrease in the balances of the accumulated deficit and of the net debt of the Government.

3. Contractual Obligations

Contractual obligations that will materially affect the level of future expenditures include transfer payment agreements, acquisitions of property and equipment, and goods and services, operating leases and funding of international organizations. At March 31, 2007, contractual obligations amount to $67,954 million ($69,960 million in 2006), of which $14,365 million pertains to fiscal year 2007-2008.

4. Contingent Liabilities

Guarantees by the Government and callable share capital in certain international organizations at March 31, 2007 amount to $165,321 million ($143,991 million in 2006), net of a recorded allowance of $815 million ($1,031 million in 2006). In addition, there are a number of contaminated sites where the Government could be obligated to incur costs.

There are thousands of claims and pending and threatened litigation cases against the Government; the total amount claimed in these instances is significant but the final outcome is not determinable. The Government has recorded an allowance for claims and litigation where it is likely that there will be a future payment and a reasonable estimate of the loss can be made.

At March 31, 2007, insurance in force relating to self-sustaining insurance programs operated by three agent enterprise Crown corporations amounted to $897,490 million ($839,382 million in 2006). The Government expects that all three corporations will cover the cost of both current claims and possible future claims.

5. Subsequent Event

On August 20, 2007, the Government of Canada announced that it has entered into an agreement for the sale of nine office buildings and their subsequent lease-back for a period of twenty-five years. The office complexes and land that are located in six major cities across Canada will be sold for an amount approximating $1,600 million. The impact of this agreement, once finalized, will be reflected in the 2007-2008 financial statements.

Other Sources of Information

Public Accounts of Canada

The *Public Accounts of Canada*, as required under section 64(1) of the Financial Administration Act, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in three volumes:

- Volume I contains the Government's audited financial statements and supporting schedules and information.
- Volume II contains details of financial operations by ministry.
- Volume III contains additional information and analyses.

Budget

The budget, usually introduced in February, presents the Government's overall fiscal plan, incorporating revenue projections and spending plans, which combine to determine the resulting budgetary balance. The budget also introduces proposals for changes in taxation.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the Government together with the reasons underlying major variances.

Debt Management Strategy

This report is tabled annually in Parliament. It provides information on the federal government's debt management strategy for the coming fiscal year.

Debt Management Report

This annual document provides an accounting of the key elements of federal debt strategy and describes various strategic and operational aspects of the Government's debt program and cash management activities over the past fiscal year.

Estimates

Each year the Government prepares Estimates in support of its request to Parliament for authority to spend public monies. This request is formalized through the tabling of appropriation bills in Parliament. The Estimates are tabled in the House of Commons by the President of the Treasury Board and consist of three parts:

Part I—The Government Expenditure Plan provides an overview of federal spending and summarizes the relationship of the key elements of the Main Estimates to the Expenditure Plan set out in the budget.

Part II—The Main Estimates directly support the Appropriations Act.

Part III—Departmental Expenditure Plans, which consist of two components—Reports on Plans and Priorities and Departmental Performance Reports.

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